Office of the Legislative Auditor

State of Montana

Report to the Legislature

June 1990

Financial-Compliance Audit

For the Two Fiscal Years Ended June 30, 1989

Montana Single Audit Report

This document is prepared in accordance with the federal Single Audit Act of 1984 and OMB Circular A-128. It contains the auditor's report on Montana's Schedule of Federal Financial Assistance for the two years ended June 30, 1989, as well as Reports on Internal Controls and Compliance, a Schedule of Questioned Costs, and Federal Issues. The Montana Comprehensive Annual Financial Report for each of the two fiscal years ended June 30, 1988 and 1989, and our reports thereon have been separately issued.

Direct resolution of federal issues to:
Single Audit Coordinator
Office of Budget and Program Planning
Room 202, State Capitol
Helena, Montana 59620
Phone (406) 444-3616

89-2

FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Office of the Legislative Auditor to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations which could have a significant financial impact. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Copies of the Single Audit Report can be obtained by contacting:

Office of the Legislative Auditor
Room 135, State Capitol
Helena, MT 59620
Phone (406) 444-3122

Office of the Legislative Auditor

Financial-Compliance Audit
For the Two Fiscal Years Ended June 30, 1989

Montana Single Audit Report

All financial-compliance audit staff were involved in the individual agency audits and statewide audits supporting this audit report. Staff involved in incorporating results from individual agency audits and statewide audits into this audit report include: Pearl M. Allen, Donna Aschenbrener, Mark C. Barry, Rebecca Dorwart, Boyd D. Gackle, Wayne Kedish, and Charles Nemec.

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:
MARY BRYSON
Operations and EDP Audit
JAMES GILLETT
Financial-Compliance Audit
JIM PELLEGRINI
Performance Audit

June 1990

The Legislative Audit Committee
of the Montana State Legislature:

This is our Single Audit Report of the State of Montana for the two years ended June 30, 1989. This document contains the auditor's report on the State of Montana's Schedule of Federal Financial Assistance for the two years ended June 30, 1989. It also contains reports on the State of Montana's internal controls and compliance with federal and state laws and regulations. The review of internal control, accounting procedures, and compliance for federal programs was conducted in accordance with Government Auditing Standards and Office of Management and Budget Circular A-128.

The review disclosed certain questioned costs and deficiencies, which are summarized in the Schedule of Questioned Costs on page 28 and the Federal Issues section of this document beginning on page 29. Most of the federal findings in this document were included in previously issued agency audit reports; however, findings B15-1 through B19-9 have been updated for information obtained after the findings were originally issued or are new findings. Management has responded to the audit findings, and the responses are included in the report following each finding. Unless satisfactorily implemented or no longer applicable, prior findings affecting federal programs are included in the Federal Issues section of this document. Generally, a prior audit finding is identified as such in the narrative of the finding.

We issued separate reports on the State of Montana's general purpose financial statements for fiscal years 1987-88 and 1988-89. These reports are included in the Montana Comprehensive Annual Financial Report issued under separate cover for each of the two fiscal years ended June 30, 1988 and 1989, and are available upon request.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

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Report on and Schedule of Federal Financial Assistance

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
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REPORT ON SUPPLEMENTARY INFORMATION - SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE

Independent Auditor's Report

To the Legislative Audit Committee
of the Montana State Legislature:

We have audited the general purpose financial statements of the State of Montana for each of the two years ended June 30, 1988 and 1989, and have issued our reports thereon dated October 19, 1988, and October 25, 1989, respectively. These general purpose financial statements are the responsibility of the State of Montana management. Our responsibility is to express an opinion on these general purpose financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

Our audits were made for the purpose of forming an opinion on the general purpose financial statements of the State of Montana taken as a whole. The accompanying schedule of federal financial assistance is presented for purposes of additional analysis and is not a required part of the general purpose financial statements. The information in that schedule has been subjected to auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, is fairly presented in all material respects in relation to the general purpose financial statements taken as a whole.

Respectfully submitted,

James Gillett

James Gillett, CPA
Deputy Legislative Auditor

May 18, 1990

STATE OF MONTANA
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE BY FEDERAL AGENCY AND PROGRAM
FOR THE TWO YEARS ENDED JUNE 30, 1989

CFDA#	FEDERAL ASSISTANCE PROGRAM BY FEDERAL AGENCY	1987-88 ASSISTANCE AMOUNT	1988-89 ASSISTANCE AMOUNT
	Department of Agriculture		
	Agriculture Research Service		
10.001	Agricultural Research-Basic and Applied Research	$ 56,639	$ 76,609
	Animal and Plant Health Inspection Section		
10.025	Plant and Animal Disease and Pest Control	82,670	270,294
	Agricultural Stabilization and Conservation Service		
10.058	Wheat Production Stabilization	0	17,912
10.063	Agricultural Conservation Program	13,492	13,967
10.064	Forestry Incentives Program	1,190	449
10.069	Conservation Reserve Program	2,409	1,063
	Agricultural Marketing Service		
10.156	Federal-State Marketing Improvement Program	4,412	28,308
	Cooperative State Research Service		
10.200	Grants for Agricultural Research, Special Research Grants	89,585	219,601
10.202	Cooperative Forestry Research	283,300	403,137
10.203	Payments to Agricultural Experiment Stations Under Hatch Act	1,773,737	1,837,337
10.207	Animal Health and Disease Research	3,973	111,759
10.214	Morrill-Nelson Funds for Food and Agricultural Higher Education	50,000	50,000
	Economic Research Service		
10.250	Agricultural and Rural Economic Research	0	10,314
	Farmers Home Administration		
10.435	Agricultural Loan Mediation Program	0	15,000
	Food Safety and Inspection Service		
10.477	Meat and Poultry Inspection	20,000	20,000
	Extension Service		
10.500	Cooperative Extension Service	2,433,256	2,650,045
	Food and Nutrition Service		
10.550	Food Distribution	10,630,153	8,092,743
10.551	Food Stamps	35,249,256	35,507,662
10.553	School Breakfast Program	800,174	787,736
10.555	National School Lunch Program	8,836,139	8,932,867
10.556	Special Milk Program for Children	65,701	64,855
10.557	Special Supplemental Food Program for Women, Infants, and Children	6,345,955	7,653,670
10.558	Child Care Food Program	2,945,463	3,455,504
10.559	Summer Food Service Program for Children	272,721	219,689
10.560	State Administrative Expenses for Child Nutrition	273,780	223,908
10.561	State Administrative Matching Grants for Food Stamp Program	5,365,765	4,915,921
10.564	Nutrition Education and Training Program	48,933	50,689
10.567	Food Distribution Programs on Indian Reservations	1,036,586	1,020,966
10.568	Temporary Emergency Food Assistance (Administrative Costs)	138,014	180,808

STATE OF MONTANA
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE BY FEDERAL AGENCY AND PROGRAM
FOR THE TWO YEARS ENDED JUNE 30, 1989

CFDA#	FEDERAL ASSISTANCE PROGRAM BY FEDERAL AGENCY	1987-88 ASSISTANCE AMOUNT	1988-89 ASSISTANCE AMOUNT
	Department of Agriculture (continued)		
	Forest Service		
10.652	Forestry Research	$ 4,404	$ 2,252
10.664	Cooperative Forestry Assistance	453,155	438,515
10.665	Schools and Roads-Grants to States	6,586,978	8,421,556
10.699	Miscellaneous Non-Major Grants	252,143	323,699
	Soil Conservation Service		
10.901	Resource Conservation and Development	16,273	17,848
10.902	Soil and Water Conservation	324	2,764
10.903	Soil Survey	25,480	10,006
	Agricultural Statistics Reports		
10.950	Agricultural Statistics Reports	10,000	10,000
	Miscellaneous		
10.999	Non-Major Grants	1,180,676	2,447,378
	TOTAL FOR AGENCY	$ 85,352,736	$ 88,506,831
	Department of Commerce		
	Economic Development Administration		
11.302	Economic Development-Support for Planning Organizations	$ 32,196	$ 14,804
11.303	Economic Development-Technical Assistance	85,994	102,777
11.307	Special Economic Development and Adjustment Assistance Program	0	65,867
	National Oceanic and Atmospheric Administration		
11.407	Interjurisdictional Fisheries Act of 1986	19,672	0
	National Institute for Standards and Technology		
11.699	Miscellaneous Non-Major Grants	55,548	28,749
	Miscellaneous		
11.999	Non-Major Grants	68,489	55,071
	TOTAL FOR AGENCY	$ 261,899	$ 267,268
	Department of Defense		
	Miscellaneous		
12.999	Non-Major Grants	$ 2,852,695	$ 3,434,324
	TOTAL FOR AGENCY	$ 2,852,695	$ 3,434,324
	Department of Health and Human Services		
	Public Health Service - I		
13.103	Food and Drug Administration-Research	$ 5,893	$ 4,291
13.110	Maternal and Child Health Federal Consolidated Programs	2,093	57,095
13.118	Acquired Immunodeficiency Syndrome (AIDS) Activity	246,688	542,996
13.146	AIDS Drug Reimbursements	0	24,591
13.150	Mental Health Services for the Homeless Block Grant	0	275,000
13.158	State Comprehensive Mental Health Service Planning Development Grant	0	40,433

STATE OF MONTANA
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE BY FEDERAL AGENCY AND PROGRAM
FOR THE TWO YEARS ENDED JUNE 30, 1989

CFDA#	FEDERAL ASSISTANCE PROGRAM BY FEDERAL AGENCY	1987-88 ASSISTANCE AMOUNT	1988-89 ASSISTANCE AMOUNT
	Department of Health and Human Services (continued)		
	Public Health Service - I (continued)		
13.217	Family Planning-Services	$ 890,514	$ 816,585
13.228	Indian Health Services-Health Management Development Program	3,628	741
13.268	Childhood Immunization Grants	582,522	941,644
13.273	Alcohol Research Programs	51,325	115,918
13.283	Centers for Disease Control-Investigations and Technical Assistance	16,984	196,125
13.337	Biomedical Research Support	42,333	57,086
13.358	Professional Nurse Traineeships	0	22,242
13.364	Nursing Student Loans	892,123	953,927
13.375	Minority Biomedical Research Support	399,843	414,103
13.393	Cancer Cause and Prevention Research	93,576	-8,222
13.395	Cancer Treatment Research	0	7,217
13.396	Cancer Biology Research	15,234	29,907
	Office of Human Development Services		
13.600	Administration for Children,Youth and Families-Head Start	0	5,720
13.612	Native American Programs-Financial Assistance Grants	0	1,531
13.631	Administration on Developmental Disabilities-Special Projects	392,057	318,994
13.632	Administration on Developmental Disabilities-University Affiliated Programs	134,611	238,210
13.633	Special Programs for the Aging-Title III, Part B-Grants for Supportive Services and Senior Centers	1,466,171	1,790,546
13.635	Special Programs for the Aging-Title III, Part C-Nutrition Services	2,165,801	2,199,820
13.645	Child Welfare Services-State Grants	1,061,266	1,009,605
13.646	Work Incentive Program	357,193	291,302
13.648	Child Welfare Services Training Grants	35,907	65,945
13.652	Administration for Children, Youth and Families-Adoption Opportunities	0	60,705
13.658	Foster Care-Title IV-E	1,961,910	2,181,245
13.667	Social Services Block Grant	9,397,264	9,292,090
13.668	Special Programs for the Aging-Title IV-Training, Research and Discretionary Projects and Programs	68,959	169,753
13.669	Administration for Children, Youth and Families-Child Abuse and Neglect State Grants	56,256	70,695
	Health Care Financing Administration		
13.714	Medical Assistance Program	109,165,086	122,081,590
13.777	State Survey and Certification of Health Care Providers and Suppliers	672,854	728,634
	Family Support Administration		
13.780	Family Support Payments to State-Assistance Payments	29,815,373	29,192,179
13.783	Child Support Enforcement	1,885,740	1,582,560
13.789	Low Income Home Energy Assistance	7,392,069	8,333,390
13.792	Community Services Block Grant	1,146,081	1,021,470
13.796	Emergency Community Services for the Homeless	81,807	182,873
	Social Security Administration		
13.802	Social Security-Disability Insurance	2,452,591	2,631,065
13.807	Supplemental Security Income	22,489	22,489
13.814	Refugee and Entrant Assistance - State Programs	137,897	46,805

STATE OF MONTANA
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE BY FEDERAL AGENCY AND PROGRAM
FOR THE TWO YEARS ENDED JUNE 30, 1989

CFDA#	FEDERAL ASSISTANCE PROGRAM BY FEDERAL AGENCY	1987-88 ASSISTANCE AMOUNT	1988-89 ASSISTANCE AMOUNT
	Department of Health and Human Services (continued)		
	Public Health Service - II		
13.853	Clinical Research Related to Neurological and Communicative Disorder	$ 120,769	$ 15,921
13.855	Immunology, Allergic and Immunologic Diseases Research	16,829	113,236
13.866	Aging Research	40,699	5,467
13.867	Retinal and Choroidal Diseases Research	256,123	158,953
13.871	Strabismus, Amblyopia and Visual Processing	6,646	33,218
13.880	Minority Access to Research Careers	1,000	14,103
	Public Health Service - III		
13.977	Preventive Health Services-Sexually Transmitted Diseases Control Grants	75,690	81,215
13.991	Preventive Health and Health Services Block Grant	782,590	622,202
13.992	Alcohol and Drug Abuse and Mental Health Services Block Grant	2,809,123	2,770,217
13.994	Maternal and Child Health Services Block Grant	1,942,073	2,133,338
13.995	Adolescent Family Life-Demonstration Projects	84,903	98,555
	Miscellaneous		
13.999	Non-Major Grants	1,524,593	1,778,839
	TOTAL FOR AGENCY	$180,773,176	$195,836,159
	Department of Housing and Urban Development		
	Housing - Federal Housing Commissioner		
14.156	Lower Income Housing Assistance Program	$ 9,585,216	$ 9,936,240
	Community Planning and Development		
14.228	Community Development Block Grant/State's Program	4,728,528	5,070,162
	Fair Housing and Equal Opportunity		
14.401	Fair Housing Assistance Program-State and Local	59,000	83,089
	Solar Energy and Energy Conservation Bank		
14.550	Solar Energy and Energy Conservation Bank (see note 8A)	-15,340	23,334
	Miscellaneous		
14.999	Non-Major Grants	56,742	56,742
	TOTAL FOR AGENCY	$ 14,414,146	$ 15,169,567
	Department of the Interior		
	Bureau of Indian Affairs		
15.142	Self Determination Grants-Indian Tribal Governments	$ 39,993	$ 42,761
15.199	Miscellaneous Non-Major Grants	36,935	9,087
	Bureau of Land Management		
15.219	Wildlife Habitat Management Technical Assistance	9,723	6,366
15.221	Cooperative Agreements for Research in Public Lands Management	68,904	108,426
15.999	Mineral Leasing	26,327,798	20,727,403

STATE OF MONTANA
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE BY FEDERAL AGENCY AND PROGRAM
FOR THE TWO YEARS ENDED JUNE 30, 1989

CFDA#	FEDERAL ASSISTANCE PROGRAM BY FEDERAL AGENCY	1987-88 ASSISTANCE AMOUNT	1988-89 ASSISTANCE AMOUNT
	Department of the Interior (continued)		
	Office of Surface Mining Reclamation and Enforcement		
15.250	Regulation of Surface Coal Mining and Surface Effects of Underground Coal Mining	$ 647,574	$ 693,604
15.252	Abandoned Mine Land Reclamation (AMLR) Program	4,712,125	5,196,528
15.299	Miscellaneous Non-Major Grants	226,266	287,026
	Bureau of Mines		
15.308	Grants for Mining and Mineral Resources and Research Institutes	227,975	329,757
	Bureau of Reclamation		
15.503	Small Reclamation Projects	1,282	11
15.599	Miscellaneous Non-Major Grants	281,430	0
	U.S. Fish and Wildlife Service		
15.604	Fishery Research-Information	105,342	73,516
15.605	Sport Fish Restoration	2,695,482	2,134,710
15.606	Migratory Bird Banding and Data Analysis	562	0
15.610	Wildlife Research Information	39,064	74,261
15.611	Wildlife Restoration	2,562,598	2,537,727
15.612	Endangered Species Conservation	168,926	178,712
15.699	Miscellaneous Non-Major Grants	224,761	259,881
	Geological Survey		
15.801	Cartographic Information	2,294	1,129
15.803	National Mapping and Surveys	11,882	55,176
15.804	Water Resources Investigations	163,806	190,091
15.806	National Water Resources Research Program	45,773	65,364
15.899	Miscellaneous Non-Major Grants	60,567	20,418
	National Park Service		
15.904	Historic Preservation Fund Grants-In-Aid	274,822	383,865
15.915	Technical Preservation Services	17,669	15,695
15.916	Outdoor Recreation-Acquisition, Development and Planning	309,288	174,042
	Miscellaneous		
15.999	Non-Major Grants	282,866	460,866
	TOTAL FOR AGENCY	$ 39,545,707	$ 34,026,422
	Department of Justice		
	Drug Enforcement Administration		
16.001	Law Enforcement Assistance-Narcotics and Dangerous Drugs-Laboratory	$ 44,183	$ 37,816
	Office of Juvenile Justice and Delinquency Prevention		
16.540	Juvenile Justice and Delinquency Prevention-Allocation to States	182,178	229,912
	Bureau of Justice Statistics		
16.550	Criminal Justice Statistics Development	8,625	25,824
	National Institute of Justice		
16.560	Justice Research and Development Projects Grants	20,655	0

STATE OF MONTANA
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE BY FEDERAL AGENCY AND PROGRAM
FOR THE TWO YEARS ENDED JUNE 30, 1989

CFDA#	FEDERAL ASSISTANCE PROGRAM BY FEDERAL AGENCY	1987-88 ASSISTANCE AMOUNT	1988-89 ASSISTANCE AMOUNT
	Department of Justice (continued)		
	Office of Justice Programs		
16.573	Criminal Justice Block Grants	$ 298,986	$ 167,866
16.575	Crime Victim Assistance	0	196,343
16.576	Crime Victim Compensation	129,000	136,000
16.579	State and Local Narcotics Control Assistance	990,519	492,558
16.581	Drug Law Enforcement Program-Prison Capacity	25,006	49,327
	Bureau of Prisons		
16.601	Corrections-Training and Staff Development	868	0
	Miscellaneous		
16.999	Non-Major Grants	295,698	208,731
	TOTAL FOR AGENCY	$ 1,995,718	$ 1,544,377
	Department of Labor		
	Bureau of Labor Statistics		
17.002	Labor Force Statistics	$ 570,306	$ 573,717
	Employment and Training Administration		
17.203	Labor Certification for Alien Workers	61,328	86,564
17.207	Employment Service	5,691,979	5,456,483
17.225	Unemployment Insurance	8,109,086	9,616,509
17.248	Employment and Training Research and Development Projects	40,596	37,539
17.249	Employment Services and Job Training-Pilot and Demonstration Program	531,678	981,201
17.250	Job Training Partnership Act	10,357,874	11,343,401
17.400	Trade Adjustment Assistance - Workers	68,277	47,322
	Occupational Safety and Health Administration		
17.500	Occupational Safety and Health	96,343	102,789
	Mine Safety and Health Administration		
17.600	Mine Health and Safety Grants	41,739	25,770
	Office of the Assistant Secretary for Veterans' Employment		
17.801	Disabled Veterans Outreach Program	253,306	260,005
17.804	Local Veterans Employment Representative Program	394,944	452,612
	Miscellaneous		
17.999	Non-Major Grants	95,842	98,013
	TOTAL FOR AGENCY	$ 26,313,298	$ 29,081,925
	Department of Transportation		
	United States Coast Guard		
20.005	Boating Safety Financial Assistance	$ 267,527	$ 239,429
	Federal Aviation Administration		
20.106	Airport Improvement Program	185,646	79,740

STATE OF MONTANA
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE BY FEDERAL AGENCY AND PROGRAM
FOR THE TWO YEARS ENDED JUNE 30, 1989

CFDA#	FEDERAL ASSISTANCE PROGRAM BY FEDERAL AGENCY	1987-88 ASSISTANCE AMOUNT	1988-89 ASSISTANCE AMOUNT
	Department of Transportation (continued)		
	Federal Highway Administration		
20.205	Highway Planning and Construction	$107,778,881	$104,272,414
20.214	Highway Beautification-Control of Outdoor Advertising, and Control of Junkyards	84	2,447
20.218	Motor Carrier Safety Assistance Program	518,132	467,936
20.299	Miscellaneous Non-Major Grants	713	0
	Federal Railroad Administration		
20.303	Grants-In-Aid for Railroad Safety-State Participation	5,457	32,836
20.308	Local Rail Service Assistance	458,610	304,847
	Urban Mass Transportation Administration		
20.500	Urban Mass Transportation Capital Improvement Grants	214,024	214,312
20.505	Urban Mass Transportation Technical Studies Grants	78,000	107,792
20.507	Urban Mass Transportation Capital and Operating Assistance Formula Grants	534,207	478,068
	National Highway Traffic Safety Administration		
20.600	State and Community Highway Safety	1,104,339	1,284,446
	Research and Special Programs Administration		
20.700	Pipeline Safety	23,562	11,820
	TOTAL FOR AGENCY	$111,169,182	$107,496,087
	Equal Employment Opportunity Commission		
30.002	Employment Discrimination-State and Local Anti-Discrimination Agency	$ 72,296	$ 98,481
	TOTAL FOR AGENCY	$ 72,296	$ 98,481
	General Services Administration		
39.003	Donation of Federal Surplus Personal Property	$ 43,293	$ 58,410
	TOTAL FOR AGENCY	$ 43,293	$ 58,410
	National Aeronautics and Space Administration		
43.002	Technology Utilization	$ 76,581	$ 109,734
43.999	Miscellaneous Non-Major Grants	174,311	189,875
	TOTAL FOR AGENCY	$ 250,892	$ 299,609
	National Foundation on the Arts and the Humanities		
	National Endowment for the Arts		
45.003	Promotion of the Arts-Arts in Education	$ 41,000	$ 29,500
45.007	Promotion of the Arts-State Programs	343,000	347,000

CFDA#	FEDERAL ASSISTANCE PROGRAM BY FEDERAL AGENCY	1987-88 ASSISTANCE AMOUNT	1988-89 ASSISTANCE AMOUNT
	National Foundation on the Arts and the Humanities (continued)		
	National Endowment for the Humanities		
45.125	Promotion of the Humanities-Humanities Projects in Museums and Historical Organizations	$ 23,846	$ 93,148
45.129	Promotion of the Humanities-State Programs	4,944	28,500
45.199	Miscellaneous Non-Major Grants	0	27,210
	Institute of Museum Services		
45.301	Institute of Museum Services	67,392	107,570
	Miscellaneous		
45.999	Non-Major Grants	5,946	0
	TOTAL FOR AGENCY	$ 486,128	$ 632,928
	National Science Foundation		
47.009	Graduate Research Fellowships	$ 718	$ 7,597
47.041	Engineering Grants	26,409	105,535
47.049	Mathematical and Physical Sciences	1,195,593	1,275,566
47.050	Geosciences	192,097	236,891
47.051	Biological, Behavioral, and Social Sciences	315,046	191,952
47.064	College Science Instrumentation Program	31,182	50,568
47.066	Teacher Preparation and Enhancement	3,478	62,635
47.067	Materials Development and Informal Science Education	11,974	-688
47.999	Miscellaneous Non-Major Grants	631,903	827,451
	TOTAL FOR AGENCY	$ 2,408,400	$ 2,757,507
	Small Business Administration		
59.005	Business Development Assistance to Small Business	$ 15,456	$ 9,632
59.037	Small Business Development Center	24,633	253,080
	TOTAL FOR AGENCY	$ 40,089	$ 262,712
	Tennessee Valley Authority		
62.001	National Fertilizer Development	$ 0	$ 3
62.005	Tennessee Valley Region-Natural Resources Development	9,359	15,881
62.999	Miscellaneous Non-Major Grants	558	0
	TOTAL FOR AGENCY	$ 9,917	$ 15,884
	Veterans Administration		
	Department of Medicine and Surgery		
64.015	Veterans State Nursing Home Care	$ 678,826	$ 739,343
	Department of Veterans' Benefits		
64.111	Veterans Educational Assistance	43,066	61,271

STATE OF MONTANA
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE BY FEDERAL AGENCY AND PROGRAM
FOR THE TWO YEARS ENDED JUNE 30, 1989

CFDA#	FEDERAL ASSISTANCE PROGRAM BY FEDERAL AGENCY	1987-88 ASSISTANCE AMOUNT	1988-89 ASSISTANCE AMOUNT
	Veterans Administration (continued)		
	Miscellaneous		
64.999	Non-Major Grants	$ 40,779	$ 21,544
	TOTAL FOR AGENCY	$ 762,671	$ 822,158
	Environmental Protection Agency		
	Office of Air and Radiation		
66.001	Air Pollution Control Program Support	$ 654,390	$ 616,794
	Office of Water		
66.418	Construction Grants for Wastewater Treatment Works	155,684	149,248
66.419	Water Pollution Control-State and Interstate Program Support	764,452	499,175
66.423	Water Quality Control Information System-Orientation/Training Seminars, Data, and Monitoring Publications	3,307	9,692
66.432	State Public Water System Supervision	376,697	491,357
66.433	State Underground Water Source Protection	16,601	9,883
66.438	Construction Management Assistance	311,274	297,753
66.454	Water Quality Management Planning	388,912	285,366
66.459	Nonpoint Source Reservation	67,972	105,574
	Office of Research and Development		
66.500	Environmental Protection-Consolidated Research	0	263,826
66.599	Miscellaneous Non-Major Grants	40,945	0
	Office of Pesticides and Toxic Substances		
66.700	Pesticides Enforcement Program	244,791	173,529
66.702	Asbestos Hazards Abatement (Schools) Assistance	3,236	95,241
	Office of Solid Waste and Emergency Response		
66.801	Hazardous Waste Management State Program Support	290,319	358,358
66.802	Hazardous Substance Response Trust Fund	3,817,788	3,869,375
66.804	State Underground Storage Tanks Program	104,502	151,058
66.805	Underground Storage Tank Trust Fund Program	140,276	438,323
66.899	Miscellaneous Non-Major Grants	37,552	112,021
	Miscellaneous		
66.999	Non-Major Grants	410,406	213,343
	TOTAL FOR AGENCY	$ 7,829,104	$ 8,139,916
	Overseas Private Investment Corporation		
70.003	Foreign Investment Insurance	$ 76,392	$ 91,536
	TOTAL FOR AGENCY	$ 76,392	$ 91,536
	Action		
72.999	Miscellaneous Non-Major Grants	$ 20,978	$ 31,376
	TOTAL FOR AGENCY	$ 20,978	$ 31,376

STATE OF MONTANA
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE BY FEDERAL AGENCY AND PROGRAM
FOR THE TWO YEARS ENDED JUNE 30, 1989

CFDA#	FEDERAL ASSISTANCE PROGRAM BY FEDERAL AGENCY	1987-88 ASSISTANCE AMOUNT	1988-89 ASSISTANCE AMOUNT
	Department of Energy		
81.041	State Energy Conservation	$ 520,321	$ 325,575
81.042	Weatherization Assistance for Low-Income Persons	1,816,926	1,580,383
81.047	Pre-Freshman Engineering	3,163	10,598
81.048	Priorities and Allocations for Energy Programs and Projects	21,810	53,778
81.049	Basic Energy Sciences, High Energy and Nuclear Physics, Magnetic Fusion Energy, Health and Environmental Research, Program Analysis and Field Operations Management	248,079	351,693
81.050	Energy Extension Service	49,491	63,630
81.052	Energy Conservation for Institutional Buildings	71,258	26,644
81.079	Biofuels and Municipal Waste Technology and Regional Programs	46,373	29,251
81.999	Petroleum Violation Escrow	3,203,150	6,789,026
81.999	Miscellaneous Non-Major Grants	1,472,949	1,365,959
	TOTAL FOR AGENCY	$ 7,453,520	$ 10,596,537
	Federal Emergency Management Agency		
	Training and Fire Programs Directorate		
83.403	Emergency Management Institute-Field Training Program	$ 148,007	$ 113,087
	State and Local Programs and Support		
83.503	Civil Defense-State and Local Emergency Management Assistance	481,689	529,461
83.505	State Disaster Preparedness Grants	88,076	97,091
83.509	Facility Survey, Engineering and Development	27,166	33,176
83.511	Radiological Defense Planning and Development	40,507	37,719
83.512	State and Local Emergency Operating Centers	164,122	88,061
83.514	Population Protection Planning	72,645	71,146
83.516	Disaster Assistance	101,488	251,365
	TOTAL FOR AGENCY	$ 1,123,700	$ 1,221,106
	Department of Education		
84.002	Adult Education-State-Administered Program	$ 498,648	$ 534,573
84.003	Bilingual Education	238,087	213,101
84.004	Civil Rights Technical Assistance and Training	194,732	200,025
84.007	Supplemental Educational Opportunity Grants	763,734	934,550
84.008	Alcohol and Drug Abuse Education	453,890	662,602
84.009	Education of Handicapped Children in State Operated or Supported Schools	379,192	392,037
84.010	Educationally Deprived Children-Local Educational Agencies	10,548,939	11,813,478
84.011	Migrant Education-Basic State Formula Grant Program	398,681	269,127
84.012	Educationally Deprived Children-State Administration	222,075	262,121
84.013	Neglected and Delinquent Children	137,606	167,090
84.024	Handicapped Early Childhood Education	252,284	323,458
84.025	Handicapped Education-Deaf-Blind Centers	65,151	70,554
84.027	Handicapped-State Grants	4,349,523	4,499,030
84.029	Handicapped Education-Special Education Personnel Development	271,219	281,921
84.031	Higher Education-Institutional Aid	579,755	537,983
84.032	Higher Education Act Insured Loans	42,869,558	49,406,893
84.033	College Work-Study Program	2,260,315	1,974,182
84.034	Library Services	426,821	434,719
84.035	Interlibrary Cooperation and Resource Sharing	45,870	56,769
84.037	National Defense/Perkins Loan Cancellations	695,401	781,389

STATE OF MONTANA
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE BY FEDERAL AGENCY AND PROGRAM
FOR THE TWO YEARS ENDED JUNE 30, 1989

CFDA#	FEDERAL ASSISTANCE PROGRAM BY FEDERAL AGENCY	1987-88 ASSISTANCE AMOUNT	1988-89 ASSISTANCE AMOUNT
	Department of Education (continued)		
84.038	Perkins Loans	$ 15,278,702	$ 16,708,844
84.042	Student Support Services	300,269	541,452
84.044	Talent Search	157,833	163,322
84.047	Upward Bound	177,092	187,697
84.048	Vocational Education-Basic Grants to States	3,061,673	5,374,108
84.053	Vocational Education-State Councils	108,597	119,663
84.055	Higher Education-Cooperative Education	68,721	76,882
84.060	Indian Education-Formula Grants to Local Educational Agencies	336,586	291,741
84.061	Indian Education-Special Programs and Projects	245,545	237,385
84.063	Pell Grant Program	13,197,298	16,108,669
84.064	Higher Education-Veterans Education Outreach Program	5,413	6,699
84.069	Grants to States for State Student Incentives	289,645	280,020
84.073	National Diffusion Network	52,832	45,018
84.078	Postsecondary Education Programs for Handicapped Persons	69,826	119,419
84.083	Women's Educational Equity	14,410	11,930
84.086	Handicapped Education-Severely Handicapped Program	256,844	0
84.087	Indian Education-Fellowships for Indian Students	36,004	55,163
84.094	Patricia Roberts Harris Fellowships	24,823	62,119
84.116	Funds for the Improvement of Postsecondary Education	85,891	98,529
84.123	Law-Related Education	256	0
84.126	Rehabilitation Services-Basic Support	5,367,253	5,636,643
84.128	Rehabilitation Services-Service Projects	433,712	502,214
84.129	Rehabilitation Training	21,849	14,562
84.133	National Institute on Disability and Rehabilitation Research	182,828	407,370
84.136	Legal Training for the Disadvantaged	167,273	3,205
84.146	Transition Program for Refugee Children	11,526	11,250
84.151	Federal, State, and Local Partnerships for Educational Improvement	2,229,873	2,403,187
84.153	Business and International Education	40,872	38,978
84.154	Public Library Construction	111,545	183,622
84.155	Removal of Architectural Barriers to the Handicapped	116,052	29,364
84.161	Client Assistance for Handicapped Individuals	34,000	0
84.164	State Grants for Strengthening the Skills of Teachers and Instruction Mathematics, Science, Foreign Languages, and Computer Learning	115,599	519,600
84.167	Library Literacy	0	18,516
84.168	Secretary's Discretionary Program for Mathematics, Science, Computer Learning, and Critical Foreign Languages	0	43,143
84.169	Comprehensive Services for Independent Living	299,490	254,213
84.173	Handicapped-Preschool Grants	0	410,080
84.174	Vocational Education-Community Based Organizations	5,399	13,287
84.176	Paul Douglas Teacher Scholarships	45,610	61,801
84.177	Rehabilitation Services-Independent Living Services for Older Blind Individuals	134,883	193,799
84.181	Handicapped Infants and Toddlers	163,493	311,395
84.185	Robert C. Byrd Honors Scholarships	60,103	1,966
84.187	Supported Employment Services for Individuals with Severe Handicaps	188,709	520,835
84.188	Drug-Free Schools and Communities-Regional Centers	238,651	273,142
84.192	Adult Education for the Homeless	0	61,089
84.196	State Activities-Education of Homeless Children and Youth	0	42,158
84.197	College Library Technology and Cooperation Grants	0	94,811
84.999	Miscellaneous Non-Major Grants	6,975	6,689
	TOTAL FOR AGENCY	$109,395,436	$126,361,181

STATE OF MONTANA
SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE BY FEDERAL AGENCY AND PROGRAM
FOR THE TWO YEARS ENDED JUNE 30, 1989

CFDA#	FEDERAL ASSISTANCE PROGRAM BY FEDERAL AGENCY	1987-88 ASSISTANCE AMOUNT	1988-89 ASSISTANCE AMOUNT
	Harry S Truman Scholarship Foundation		
85.001	Harry S Truman Scholarship Program	$ 21,967	$ 0
	TOTAL FOR AGENCY	$ 21,967	$ 0
	Agency for International Development		
.*	Miscellaneous Non-Major Grants	$ 82,008	$ 10,545
	TOTAL FOR AGENCY	$ 82,008	$ 10,545
	National Association for Foreign Student Affairs		
.*	Miscellaneous Non-Major Grants	$ 0	$ 822
	TOTAL FOR AGENCY	$ 0	$ 822
	GRAND TOTAL	$592,755,348	$626,763,668

STATE OF MONTANA
NOTES TO THE SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE
FOR THE TWO YEARS ENDED JUNE 30, 1989

Note 1 - BASIS OF ACCOUNTING

Except as documented in notes 4 through 8 below, the assistance amounts presented on the accompanying Schedule of Federal Financial Assistance of the State of Montana are expenditures or reimbursement revenues recorded on the modified accrual basis. This method recognizes expenditures in the accounting period in which the liability is incurred and revenues when measurable and available.

Note 2 - MAJOR FEDERAL FINANCIAL ASSISTANCE PROGRAMS

In accordance with the criteria established by P.L. 98-502 and OMB Circular A-128, a major federal financial assistance program for the State of Montana is defined as any federal program having assistance to the State of Montana exceeding $3 million for the year ended June 30, 1988 or 1989.

Note 3 - CFDA #

The CFDA # assigned for each federal program listed in the Schedule of Federal Financial Assistance was based upon the December 1988 Catalog of Federal Domestic Assistance and agency agreements with the federal government. Programs not assigned a CFDA # in the December 1988 Catalog of Federal Domestic Assistance were assigned a CFDA # in the format **.*99. The first two digits represent the federal agency and the third digit represents the division within the federal agency. In cases where the division could not be identified, the program was assigned a CFDA # in the format **.999 where the first two digits designate the federal granting agency from which the state received the assistance. There are no CFDA numbers assigned to federal assistance from the Agency for International Development and the National Association for Foreign Student Affairs.

Note 4 - FOOD DISTRIBUTION PROGRAM

The amount reported for the Food Distribution program (CFDA #10.550) represents the dollar value of food commodities distributed to eligible recipients during the year. The United States Department of Agriculture provided the current value of the commodities used by the state to compute the amount reported.

Note 5 - FOOD STAMPS PROGRAM

The amount reported for the Food Stamps program (CFDA #10.551) represents the face value of the food stamps issued to eligible recipients.

Note 6 - PERKINS LOAN PROGRAM

The amount reported for the Perkins Loan program (CFDA #84.038) represents the amount of loans outstanding and administrative costs expended at June 30 of each year presented.

Note 7 - HIGHER EDUCATION ACT INSURED LOANS

The amounts presented for Higher Education Act Insured Loans (CFDA #84.032) represents the amount of new loans guaranteed plus administrative expenses during each year presented.

Note 8 - PRIOR YEAR ADJUSTMENTS

The amounts reported include prior year expenditure adjustments. Three significant prior year expenditure items are as follows:

A. The Department of Social and Rehabilitation Services expended $57,886 from the Department of Housing and Urban Development in 1986-87 to fund a Solar Energy program. In 1987-88, the department made a $15,430 adjustment to reduce the expenditures reported in 1986-87. The amount reported for CFDA #14.550 for 1987-88 is the prior year expenditure adjustment.

B. The Montana Department of Commerce expended $45,645 in 1986-87 from the Federal Aviation Administration to fund a Statewide System Aviation plan. The amount reported for CFDA #20.106 for 1987-88 includes this amount.

C. The Governor's Office expended $34,000 for the Client Assistance for Handicapped Individuals program in 1986-87. This amount is reported for CFDA #84.161 in 1987-88.

Note 9- SUBGRANTS

The following subgrants do not appear on the Schedule of Federal Financial Assistance.

A. Montana State University expended $130,429 in 1988-89 and $76,421 in 1987-88 of federal moneys subgranted through the University of California-Davis. University of California-Davis received these funds from the Agency for International Development.

B. The Montana Department of Highways received a subgrant of $113,264 in 1987-88 and $8,138 in 1988-89 from the U.S. Department of Transportation. The U.S. Department of Transportation received these funds from the U.S. Department of Defense (Air Force) under contract #OMAD 300(28).

Reports on Internal Controls

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:

MARY BRYSON
Operations and EDP Audit

JAMES GILLETT
Financial-Compliance Audit

JIM PELLEGRINI
Performance Audit

REPORT ON THE INTERNAL CONTROL STRUCTURE IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Legislative Audit Committee
of the Montana State Legislature:

We have audited the general purpose financial statements of the State of Montana as of and for each of the two years ended June 30, 1988 and 1989, and have issued our reports thereon dated October 19, 1988, and October 25, 1989, respectively. We conducted our audits in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement.

In planning and performing our audits of the general purpose financial statements of the State of Montana as of and for each of the two years ended June 30, 1988 and 1989, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide assurance on the internal control structure.

The management of the State of Montana is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of general purpose financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories.

Cash	Payroll
Revenue/Receivables	Inventory
Expenditures/Payables	Property, Plant and Equipment
Investments	Central Data Processing

Our consideration of the internal control structure included all of the control categories listed above except we did not evaluate the internal control structure over Property, Plant and Equipment because it was more efficient to perform substantive testing. The purpose of our consideration of the internal control structure was to determine the nature, timing, and extent of auditing procedures necessary for expressing an opinion on the general purpose financial statements.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above.

However, we noted certain matters involving the internal control structure and its operation that we have reported to the management of the State of Montana in separate communications as part of individual agency audits.

This report is intended for the information of management, the federal cognizant audit agency, federal grantor agencies, and the Montana State Legislature. This restriction is not intended to limit the distribution of this report, which, upon acceptance by the Legislative Audit Committee, is a matter of public record.

Respectfully submitted,

James Gillett

James Gillett, CPA
Deputy Legislative Auditor

May 18, 1990

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:

MARY BRYSON
Operations and EDP Audit

JAMES GILLETT
Financial-Compliance Audit

JIM PELLEGRINI
Performance Audit

REPORT ON INTERNAL CONTROLS (ACCOUNTING AND ADMINISTRATIVE) BASED ON A STUDY AND EVALUATION MADE AS A PART OF AN AUDIT OF THE GENERAL PURPOSE FINANCIAL STATEMENTS AND THE ADDITIONAL TESTS REQUIRED BY THE SINGLE AUDIT ACT

To the Legislative Audit Committee
of the Montana State Legislature:

We have audited the general purpose financial statements of the State of Montana, as of and for each of the two years ended June 30, 1988 and 1989, and have issued our reports thereon dated October 19, 1988, and October 25, 1989, respectively. As part of our audits, we made a study and evaluation of the internal control systems, including applicable internal administrative controls, used in administering federal financial assistance programs to the extent we considered necessary to evaluate the systems as required by generally accepted auditing standards, Government Auditing Standards, issued by the Comptroller General of the United States, the Single Audit Act of 1984, and the provisions of Office of Management and Budget Circular A-128, Audits of State and Local Governments. For the purpose of this report, we have classified the significant internal accounting and administrative controls used in administering federal financial assistance programs in the following categories:

Accounting

Cash
Revenue/Receivables
Expenditures/Payables
Investments
Payroll
Inventory
Property, Plant and Equipment
Central Data Processing

Administrative

General Requirements
Political Activity
Davis-Bacon Act
Civil Rights
Cash Management
Relocation Assistance and Real Property Acquisition
Federal Financial Reports

Specific Requirements
Types of Service
Eligibility
Matching, Level of Effort
Reporting
Cost Allocation
Special Requirements
Monitoring Subrecipients

The management of the State of Montana is responsible for establishing and maintaining internal control systems used in administering federal financial assistance programs. In fulfilling that responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of internal control systems used in administering federal financial assistance programs are to provide management with reasonable, but not absolute, assurance that, with respect to federal financial assistance programs, resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data are obtained, maintained, and fairly disclosed in reports.

Because of inherent limitations in any system of internal accounting and administrative controls used in administering federal financial assistance programs, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the systems to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study included all of the applicable control categories listed above. During each of the two years ended June 30, 1988 and 1989, the State of Montana expended 86 percent of its total federal financial assistance under major federal financial assistance programs. With respect to internal control systems used in administering major federal financial assistance programs, our study and evaluation included considering the types of errors and irregularities that could occur, determining the internal control procedures that should prevent or detect such errors and irregularities, determining whether the necessary procedures are prescribed and are being followed satisfactorily, and evaluating any weaknesses.

With respect to the internal control systems used solely in administering the nonmajor federal financial assistance programs of the State of Montana, our study and evaluation was limited to a preliminary review of the systems to obtain an understanding of the control environment and the flow of transactions through the accounting system. Our study and evaluation of the internal control systems used solely in administering the nonmajor federal financial assistance programs of the State of Montana did not extend beyond this preliminary review phase.

Our study and evaluation was more limited than would be necessary to express an opinion on the internal control systems used in administering the federal financial assistance programs of the State of Montana. Accordingly, we do not express an opinion on the internal control systems used in administering the federal financial assistance programs of the State of Montana. Further, we do not express an opinion on the internal control systems used in administering the major federal financial assistance programs of the State of Montana.

Also, our audit, made in accordance with the standards mentioned above, would not necessarily disclose material weaknesses in the internal control systems used solely in administering nonmajor federal financial assistance programs.

However, our study and evaluation and our audit disclosed conditions concerning management controls at Montana State University and the Department of Family Services that we believe result in more than a relatively low risk that errors or irregularities in amounts that would be material to a federal financial assistance program may occur and not be detected within a timely period. These conditions are discussed in issues A6-1 to A6-1i and B11-4, respectively, in the Federal Issues section of this document.

These conditions were considered in determining the nature, timing, and extent of the audit tests to be applied in (1) our audits of the general purpose financial statements as of and for each of the two years ended June 30, 1988 and 1989, and (2) our audit and review of the State of Montana's compliance with laws and regulations, noncompliance with which we believe could have a material effect on the allowability of program expenditures for each major federal financial assistance program and nonmajor federal financial assistance programs. This report does not affect our reports on the general purpose financial statements dated October 19, 1988, and October 25, 1989, and on the State of Montana's compliance with laws and regulations dated May 18, 1990.

This report is intended solely for the use of management, the federal cognizant audit agency, federal grantor agencies, and the Montana State Legislature, and should not be used for any other purpose. This restriction is not intended to limit the distribution of this report, which, upon acceptance by the Legislative Audit Committee, is a matter of public record.

Respectfully submitted,

James Gillett

James Gillett
Deputy Legislative Auditor

May 18, 1990

Reports on Compliance and Schedule of Questioned Costs

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:
MARY BRYSON
Operations and EDP Audit
JAMES GILLETT
Financial-Compliance Audit
JIM PELLEGRINI
Performance Audit

COMPLIANCE REPORT BASED ON AN AUDIT OF GENERAL PURPOSE FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Legislative Audit Committee
of the Montana State Legislature:

We have audited the general purpose financial statements of the State of Montana as of and for the each of the two years ended June 30, 1988 and 1989, and have issued our reports thereon dated October 19, 1988, and October 25, 1989, respectively. We conducted our audits in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to the State of Montana is the responsibility of the State of Montana management. As part of obtaining reasonable assurance about whether the general purpose financial statements are free of material misstatement, we performed tests of the State of Montana's compliance with certain provisions of laws, regulations, contracts, and grants. However, our objective was not to provide an opinion on overall compliance with such provisions.

The results of our tests indicate that, with respect to the items tested, the State of Montana complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that the State of Montana had not complied, in all material respects, with those provisions.

This report is intended for the information of management, the federal cognizant agency, federal grantor agencies, and the Montana State Legislature. This restriction is not intended to limit the distribution of this report, which upon acceptance by the Legislative Audit Committee, is a matter of public record.

Respectfully submitted,

James Gillett

James Gillett, CPA
Deputy Legislative Auditor

May 18, 1990

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:
MARY BRYSON
Operations and EDP Audit
JAMES GILLETT
Financial-Compliance Audit
JIM PELLEGRINI
Performance Audit

SINGLE AUDIT OPINION ON COMPLIANCE WITH SPECIFIC REQUIREMENTS APPLICABLE TO MAJOR FEDERAL FINANCIAL ASSISTANCE PROGRAMS

To the Legislative Audit Committee
of the Montana State Legislature:

We have audited the State of Montana's compliance with the requirements governing types of services allowed or unallowed; eligibility; matching, level of effort, or earmarking; reporting; cost allocation; special requirements; claims for advances and reimbursements; and amounts claimed or used for matching that are applicable to each of its major federal financial assistance programs, which are identified in the accompanying schedule of federal financial assistance, for the two years ended June 30, 1989. The management of the State of Montana is responsible for the State of Montana's compliance with those requirements. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards, Government Auditing Standards, issued by the Comptroller General of the United States, and Office of Management and Budget Circular A-128, Audits of State and Local Governments. Those standards and OMB Circular A-128 require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the State of Montana's compliance with those requirements. We believe our audit provides a reasonable basis for our opinion.

The results of our audit disclosed immaterial instances of noncompliance with the requirements referred to above, which are described in the accompanying Schedule of Questioned Costs and the Federal Issues section of this document. We considered these instances of noncompliance in forming our opinion on compliance, which is expressed in the following paragraph.

In our opinion, the State of Montana complied, in all material respects with the requirements governing types of services allowed or unallowed; eligibility; matching, level of effort, or earmarking; reporting; cost allocation; special requirements; claims for advances and reimbursements; and amounts claimed or used for matching that are applicable to each of its major federal financial assistance programs for the two years ended June 30, 1989.

Respectfully submitted,

James Gillett

James Gillett
Deputy Legislative Auditor

May 18, 1990

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:

MARY BRYSON
Operations and EDP Audit

JAMES GILLETT
Financial-Compliance Audit

JIM PELLEGRINI
Performance Audit

SINGLE AUDIT REPORT ON COMPLIANCE WITH THE GENERAL REQUIREMENTS APPLICABLE TO MAJOR FEDERAL FINANCIAL ASSISTANCE PROGRAMS

To the Legislative Audit Committee
of the Montana State Legislature:

We have applied procedures to test the State of Montana's compliance with the following requirements applicable to each of its major federal financial assistance programs, which are identified in the schedule of federal financial assistance for the two years ended June 30, 1989.

Political Activity
Davis-Bacon Act
Civil Rights
Cash Management
Relocation Assistance and Real Property Acquisition
Federal Financial Reports

Our procedures were limited to the applicable procedures described in the Office of Management and Budget's Compliance Supplement for Single Audits of State and Local Governments, the Catalog of Federal Domestic Assistance, and state plans. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on the State of Montana's compliance with the requirements listed in the preceding paragraph. Accordingly, we do not express such an opinion.

With respect to the items tested, the results of those procedures disclosed no material instances of noncompliance with the requirements listed in the first paragraph of this report. With the respect to items not tested, nothing came to our attention that caused us to believe that the State of Montana had not complied in all material respects, with those requirements. However, the results of our procedures disclosed immaterial instances of noncompliance with those requirements, which are described in the accompanying Schedule of Questioned Costs and the Federal Issues section of this document.

This report is intended for the information of management, the federal cognizant audit agency, federal grantor agencies, and the Montana State Legislature. This restriction is not intended to limit the distribution of this report, which, upon acceptance by the Legislative Audit Committee, is a matter of public record.

Respectfully submitted,

James Gillett

James Gillett
Deputy Legislative Auditor

May 18, 1990

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:

MARY BRYSON
Operations and EDP Audit

JAMES GILLETT
Financial-Compliance Audit

JIM PELLEGRINI
Performance Audit

SINGLE AUDIT REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO NONMAJOR FEDERAL FINANCIAL ASSISTANCE PROGRAM TRANSACTIONS

To the Legislative Audit Committee
of the Montana State Legislature:

In connection with our audit of the general purpose financial statements of the State of Montana as of and for each of the two years ended June 30, 1988 and 1989, and with our study and evaluation of the State of Montana's internal control systems used to administer federal financial assistance programs, as required by Office of Management and Budget Circular A-128, Audits of State and Local Governments, we selected certain transactions applicable to certain nonmajor federal financial assistance programs for the two fiscal years ended June 30, 1989.

As required by OMB Circular A-128, we have performed auditing procedures to test compliance with the requirements governing types of services allowed or unallowed; eligibility; and compliance with state laws and regulations that are applicable to those transactions. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on the State of Montana's compliance with these requirements. Accordingly, we do not express such an opinion.

With respect to the items tested, the results of those procedures disclosed no material instances of noncompliance with the requirements listed in the preceding paragraph except for instances disclosed in connection with our review of the nonmajor federal financial assistance programs administered by Montana State University (MSU). The results of our review of MSU's nonmajor federal financial assistance programs revealed that MSU did not (1) comply with applicable purchasing requirements, (2) document the state's matching requirement, and (3) spend in accordance with approved budgets. These issues are further described in the accompanying Schedule of Questioned Costs and issues A6-1 through A6-1i in the Federal Issues section of this document.

In addition, the results of our procedures disclosed immaterial instances of noncompliance with those requirements, which are described in the accompanying Schedule of Questioned Costs and the Federal Issues section of this document. With respect to items not tested, nothing came to our attention that caused us to believe that the State of Montana had not complied, in all material respects, with those requirements.

This report is intended for the information of management, the federal cognizant audit agency, federal grantor agencies, and the Montana State Legislature. This restriction is not intended to limit the distribution of this report, which, upon acceptance by the Legislative Audit Committee, is a matter of public record.

Respectfully submitted,

James Gillett

James Gillett
Deputy Legislative Auditor

May 18, 1990

STATE OF MONTANA
SCHEDULE OF QUESTIONED COSTS
FOR THE TWO YEARS ENDED JUNE 30, 1989

STATE AGENCY: CFDA #	PROGRAM NAME (Project #)	AMOUNTS QUESTIONED	FINDING REFERENCES
Western Montana College:			
84.063	Pell	$ 915	A3-1
Montana State University:			
13.867	ROS Proteins (7R01-EY06913-01)	94,100	A6-1a
13.867	Protein Interactions (7R01-EY06914-01)	71,682	A6-1a
13.999	Instrumentation (1-575-EY07996-01)	11,924	A6-1b
47.999	Fire Workshop	16,281	A6-1c
84.031	Chemical Info (D-O-ED-2-8-01003)	451,171	A6-1d and A6-1g
47.999	Sea Ice (MSM-8722904)	170,000	A6-1d and A6-1g
13.867	ROS Proteins (7R01-EY06913-01)	41,658	A6-1e
13.867	Protein Interactions (7R01EY06914-01)	31,250	A6-1e
13.999	NMR Studies (1-510-RR0343301)	300,000	A6-1g
13.867	Lipids & Proteins (2R01EY06913-03)	1,428	A6-1h
81.049	Power Consolidation (DE-AC22-87PC-796)	2,574	A6-1h
13.999	Antibodies Cont. 416 (5-R01-N523642-02)	1,676	A6-1h
13.999	ROS Protein Cont. 45 (5R01EY06913-02)	3,063	A6-1h
Department of Commerce:			
14.156	Section 8	undeterminable	B5-1b
Department of State Lands:			
15.252	Abandoned Mine Land Reclamation	44,450	B9-3
Department of Family Services:			
13.633	Aging Grant	130	B11-2d
Department of Social and Rehabilitation Services:			
13.714	Medicaid	88,246	B12-3
10.561	Food Stamps	3,428	B12-3
13.789	Low Income Home Engergy Assistance	31,207	B12-6
84.126	Basic Support	1,437	B12-12
Montana Arts Council:			
45.003	Basic State Grant	150	B13-2
Office of Public Instruction:			
84.151	ECIA Chapter II	108,436 *	B17-1
10.555	School Foods	377	B17-2
Department of Health and Environmental Sciences:			
10.557	WIC	13,472	B18-2
10.558	Child Nutrition	1,160	B18-2
Department of Labor and Industry:			
17.250	Job Training Partnership Act	1,144	B19-8
17.250	Job Training Partnership Act	1,575	B19-9
TOTAL QUESTIONED COSTS IN THIS SINGLE AUDIT REPORT		$1,492,934	

* The amount questioned for ECIA II ranges from $108,436 to $151,811. We previously questioned $527,600 through June 30, 1987 for the same issue. The issue and related questioned costs were not resolved as of May 18, 1990.

Federal Issues, Recommendations, and Responses by State Agency

Section A - Higher Education Agencies

Section B - Other State Agencies

Federal Issues
The Board of Regents and Commissioner of Higher Education

A1-1. Subrecipient Monitoring

In fiscal year 1987-88, the Board of Regents became the state recipient of funds from the Carl D. Perkins Federal Vocational Act (Basic Grants to States, Catalog of Federal Domestic Assistance (CFDA) #84.048; Consumer and Homemaking Education, CFDA #84.049; Community Based Organizations, CFDA #84.174) under section 20-16-102, MCA. The board administers post-secondary level projects and contracts with the Office of Public Instruction (OPI) to administer secondary level projects for vocational education. The Commissioner of Higher Education (CHE) expended approximately $3 million and $5.4 million under the Carl D. Perkins Federal Vocational Act in fiscal years 1987-88 and 1988-89, respectively. These amounts include transfers to OPI of $867,363 and $2,884,346 for each fiscal year, respectively.

For post-secondary vocational education projects, CHE distributes Carl D. Perkins funds to vocational-technical centers, school districts, local governments, and community-based programs. For secondary vocational education projects, CHE transfers funds to OPI, which distributes them to eligible subrecipients.

CHE performs desk reviews on cost reports and supporting documentation submitted quarterly by subrecipients. In addition, they perform federally required program reviews of 20 percent of sponsored projects each year. We noted that CHE's follow up on deficiencies found during one program review consisted of sending a letter to the subrecipient outlining problems noted during the review. Subsequent correspondence from the subrecipient indicated that all recommendations were implemented. We later found that the problems were not resolved.

We also found CHE does not have procedures to adequately monitor subrecipients' compliance with federal audit requirements. The Office of Management and Budget (OMB) Circular

A-128 requires state governments which receive federal financial assistance and provide $25,000 or more of it in a fiscal year to a single subrecipient (which CHE did during the audit period) to determine whether subrecipients have met the federal audit requirements. Since federal requirements effectively place responsibility for the subrecipients' compliance with federal laws with the primary recipient, CHE should have a system for ensuring it is aware of problems at the subrecipient level. CHE should also have procedures for resolving any problems noted on the subrecipient level within six months as required by federal regulations.

CHE should require each subrecipient of $25,000 or more each year to obtain an annual audit in accordance with federal audit requirements and submit the audit reports to CHE for review. CHE should also ensure OPI and its subrecipients comply with these requirements. The contract between CHE and OPI should outline responsibility for monitoring of the subrecipients and compliance with audit requirements.

Recommendation A1-1

We recommend CHE:

A. **Establish procedures to ensure deficiencies noted during its program reviews are corrected.**

B. **Establish a system to monitor Carl D. Perkins subrecipients for compliance with federal audit requirements.**

Response A1-1

Concur. Currently, the Office of the Commissioner of Higher Education (CHE) does receive copies of the annual audit reports of each of the University System units, Vocational Technical Centers, and Community Colleges. Additionally, we also

contract with the State Department of Labor and Industry to have annual audits performed for the Community Based Organizations. These audits are reviewed by CHE's fiscal staff and any instances of non-compliance are pursued.

The staff of CHE has developed policy, in conjunction with the Office of Public Instruction (OPI) for secondary recipients, to assure ourselves of compliance with federal requirements.

1. Beginning with Project Year 1992, the annual application from subrecipients will include assurances that they will obtain an audit in accordance with federal audit requirements and will provide a copy of this audit to CHE or OPI.

2. Beginning with Project Year 1990, the close-out process will include a check-off indicating the receipt and review of audit reports.

3. Beginning with Project Year 1990, program reviews which indicate necessary corrective action will automatically be reviewed the following year.

Additionally, CHE has requested that subrecipients who received over $25,000 in funds during Project Year 1990 furnish CHE or OPI with a copy of their audited financial report if they have not already done so.

Federal Issues
Eastern Montana College

A2-1.
Federal Record Retention

During our testing of the Guaranteed Student Loan Program (GSL) (CFDA #84.032), we noted that Eastern Montana College (EMC) did not retain its Student Status Confirmation Reports for any period prior to fall quarter 1987. Student Status Confirmation Reports indicate the enrollment status of students with GSL's. When a student has graduated, withdrawn or ceased to be enrolled at least half-time, the student must begin repayment of a GSL. Federal regulations (34 CFR 682.612) require that a "school shall also keep, for five years after their completion, copies of reports and other forms utilized by the school related to GSL's." EMC officials were not aware of the requirement to keep these reports for a period of five years.

Recommendation A2-1

We recommend EMC retain financial aid records in accordance with federal regulations.

Response A2-1
EMC is retaining financial aid records for five years in accordance with federal regulations.

A2-2.
Guaranteed Student Loan Reporting

Federal regulations (34 CFR 682.612) require schools participating in the Guaranteed Student Loan Program (CFDA #84.032) to report changes in participating students' enrollment status to either the central service center on a Student Status Confirmation Report (SSCR) or directly to the lending institution. EMC uses both of these methods to notify lending institutions. Federal regulations require changes in a student's enrollment status to be reported to the lender within sixty days.

During our audit, we noted that in five out of the ten items tested, the college did not notify lenders within sixty days of when GSL recipients withdrew, graduated, or ceased to be

enrolled at least half-time. Notification of lenders was not timely because EMC does not ensure the SSCR information being requested by the central service center is complete. Of the five exceptions, two students failed to register for classes after fall quarter 1987, one student failed to register for classes after winter quarter 1988, and the other two students failed to register for classes after spring quarter 1988. The students' names did not appear on the SSCR immediately following the quarter they ceased to be enrolled, but appeared on an SSCR subsequent to that. Since EMC is ultimately responsible for notifying lending institutions, it should implement procedures to ensure the SSCR listing provided by the central service center is complete and requests the status of all EMC students with guaranteed student loans. Timely notification of lenders was also addressed in our previous audit report. EMC concurred with our prior recommendation.

Recommendation A2-2

We recommend EMC implement procedures to ensure the Student Status Confirmation Report requests the enrollment status of all EMC students with guaranteed student loans.

Response A2-2

In order to comply with the 60 day reporting requirement, EMC has been sending two SSCR tapes each quarter since spring quarter 1989. A new computer program was developed listing borrowers who have dropped below 6 credit hours. The list provides comparison with the relevant quarter SSCR report. In addition, a hard copy of the SSCR information is submitted twice each quarter to the Montana Guarantee Agency for review.

A2-3.
Guaranteed Student Loan Applications

For the Guaranteed Student Loan Program (CFDA #84.032), federal regulations (34 CFR 682.605) require a school to "accurately and completely fill out its portion of a student's loan application." The information requested from the school includes the student's eligibility for the loan and estimated cost of attendance for the period for which the loan is sought. Cost of attendance is equal to the sum of fees, room and board, books, and miscellaneous expenses for an academic year. The fees are estimated based on the student's residency status.

In our testing of 21 GSL applications, we noted three instances where EMC entered the wrong cost of attendance on the GSL application. In one instance, EMC used a higher non-resident cost of attendance when the resident cost of attendance amount should have been used. In the other two cases, EMC entered the cost of full-time attendance rather than half-time cost of attendance. The college does not have procedures to detect errors of this type. All three errors overstated the students' cost of attendance and did not comply with federal regulations.

The errors did not result in overawards since in fiscal year 1986-87, GSL's were not based on financial need. In the future, these errors could result in overawards since GSL's are currently based on financial need.

Recommendation A2-3

We recommend EMC implement procedures to ensure GSL application information is accurate and in accordance with federal regulations.

Response A2-3

Since January 1989, loan applications have been printed directly from the computer data base to ensure cost of attendance, resources, financial aid awards, loan period, social security

number, and other required information agrees with information in the award file.

A2-4. Grant Report Submission

EMC received and expended $4,620,954 and $4,639,597 in federal assistance during fiscal years 1986-87 and 1987-88, respectively. Most of the college's federal grants require financial and/or performance type reports and specify report submission requirements.

We tested EMC's compliance with federal grant reporting requirements and noted problems related to timely report submission. One out of four financial status reports and two out of five performance reports were not submitted in accordance with the grant provisions. The three late reports were as follows:

Grant Name	CFDA #	Due Date	Date Submitted	# Days Late
Personnel Preparation	84.029	9/30/87	4/19/88	202
Air Force-Bentley	85.013	3/31/88	9/30/88	183
Upward Bound	84.047	12/1/86	12/17/86	16

According to EMC personnel, the three reports were late due to employee oversights and insufficient time to complete the reports. EMC should review federal grant provisions and monitor the status of the federal grants to ensure the college is in compliance with federal reporting requirements.

Recommendation A2-4

We recommend EMC implement procedures to ensure compliance with federal grant reporting provisions.

Response A2-4

Financial status reports are filed on a timely basis by the Business Office. Project directors are reminded by the Grants Accountant of the deadline for filing of performance reports.

At the current time, one performance report has not been timely filed. The extenuating circumstances have been provided to NSF in a letter by the Dean of Arts and Sciences, and a targeted date for report submission has been identified.

A3-1. Documentation of Student Aid

Western Montana College participates in the following federal financial aid programs to benefit its students: Perkins Loans; Pell Grants; Stafford Loans (formerly Guaranteed Student Loans); College Work-Study (CWS); Supplemental Educational Opportunity Grants (SEOG); and State Student Incentive Grants (SSIG). The college determines eligibility for campus-based programs such as Perkins loans and CWS and processes applications for Pell grants. The following paragraph addresses federal financial aid compliance issues noted during our audit.

According to general compliance requirements in the federal regulations for Student Financial Assistance Programs, (34 CFR 668.7), a grant, loan and/or work-study award may be made only to a student who does not owe a refund on a federal grant and is not in default on a federally-funded or insured student loan. A student must certify that he or she is not in default and does not owe a refund. Another requirement in the federal regulations, (34 CFR 668.14), states that if the institution is disbursing Pell or campus-based funds it must obtain a financial aid transcript if the recipient previously attended another eligible institution and maintain the transcript on file. One student aid file out of 31 tested did not contain the required certification or a financial aid transcript. We were unable to verify this certification and therefore we question the allowability of the student's $915 Pell grant award for fiscal year 1986-87 (CFDA #84.063).

The file indicated the student previously attended two other schools. The file contained one financial aid transcript but college officials overlooked obtaining a transcript from the second school.

Recommendation A3-1

We recommend the college:

A. Obtain signed documentation from student applicants that prevlous financial aid obligations have been met.

B. Obtain and include all required documents in the financial aid files.

Response A3-1

The college as a matter of procedure does obtain the required certification and/or financial aid transcripts prior to any disbursement of Pell and campus-based funds. In this case, the incomplete file was corrected by obtaining the missing document for the student's file.

A3-2. Property Accounting and Control

State accounting policy requires a system to account for and control property, plant, and equipment. Adequate property control procedures and accounting records are essential for the protection of college property.

In the previous two audit reports we recommended that the college comply with state policy for property accounting and management and that the college complete implementation of its property accounting system. College personnel made progress in implementing a property accounting system during the past two audit periods. However, the college is still not in compliance with state policy for property accounting and management and the college has not completed implementation of its property accounting system. Non-compliance with property accounting and management may affect federal assistance received from the following federal agencies: Department of Education (CFDA #84.048, 84.031, 84.164, 84.116), Department of Agriculture (CFDA #10.665), and Department of Energy (CFDA #81.052).

We noted the following instances of noncompliance with Chapter 2-1700 of the Montana Operations Manual, which contains the state's property accounting policies:

1. WMC personnel do not perform an annual inventory of fixed assets/equipment. The college last performed a physical inventory of its fixed assets during spring 1985. State policy requires an annual inventory be taken when the fixed asset inventory system is periodic, rather than perpetual.

2. Not all property items at the college had inventory tags attached.

3. Not all property at WMC was recorded on the inventory system. An inventory of one of WMC's buildings was not completed. We noted two original C.M. Russell pen and ink drawings and a Paxson oil painting were not recorded on the inventory system.

4. Proper control of the state's Property Accountability and Management System (PAMS) inventory tags has not been maintained. During the initial tagging of equipment/fixed assets at WMC, a list of the PAMS tags used and the related items tagged was not created.

Our prior audit report recommended that adjustments be made to WMC's property accounting system. The college made the recommended adjustments to its property accounting system but did not make the adjustments on the state's accounting system.

College personnel should review and implement procedures to comply with state policy for property accounting and management. The college should also complete implementation of the college's property accounting and management system by taking a complete inventory of property and equipment, tagging the items and recording the items on its records and the state's accounting system.

College personnel stated the property accounting issues noted above resulted from lack of resources. They indicated the college used to commit one-half an FTE plus some student help to property accounting and control. After the half-time person

left, the function was assigned to the college's accountant to work on when time permits. College officials stated it would require at least one-half an FTE, at an estimated cost of $9,740, to complete the initial inventory. Once the inventory is performed the college would have a perpetual system. The college could then update its inventory system every time it purchased or disposed of a fixed asset and the college could develop and implement a rotating cycle to perform a physical inventory.

Recommendation A3-2

We recommend the college:

A. Perform a complete physical inventory of fixed assets.

B. Comply with state policy for property accounting and management.

C. Complete implementation of its property accounting system.

Response A3-2

Approximately forty percent of the campus has been inventoried at this time. With additional assistance from University of Montana personnel, a complete physical inventory will be taken in June 1990.

A3-3. Internal Controls

Western Montana College transmits accounting transactions to the Statewide Budgeting and Accounting System (SBAS). During our audit we noted that a lack of segregation of duties exists regarding the input and transmission of certain types of transactions to SBAS. In some situations, one person may prepare the documents, input the information to the computer and transmit the transactions to SBAS. A separate, independent review of the information is not performed prior to transmission. This control weakness could effect both state and federal

programs administered by the college. The college receives federal funds from the Department of Education (CFDA #84.007, 84.069, 84.033, 84.063, 84.048, 84.164, 84.116, 84.031, and 84.038); the Department of Agriculture (CFDA #10.665); the Department of Energy (CFDA #81.052); and the Department of Health and Human Services (CFDA #13.600).

In other situations, the documents are prepared and independently reviewed prior to transmission, however, the review and authorization is not documented.

Adequate internal controls require separate review procedures to detect errors and prevent the submission of unauthorized transactions. Procedures should exist to document the review and approval of transactions and a method should be developed to indicate the person responsible for authorizing such transactions. This formal approval should be required before a transaction is processed.

Segregating the preparation and documenting the review and approval of all accounting entries can reduce the risk that incorrect or unauthorized transactions are processed.

Recommendation A3-3

We recommend the college develop and implement procedures to segregate duties and document review and approval of transactions recorded on SBAS.

Response A3-3

With the implementation of On-Line Entry to SBAS, procedures have also been implemented which segregate duties of input from approval for all necessary document transactions recorded on SBAS. The legislative auditor performed a system review of the input/approval process and responded with no inadequacies.

Federal Issues
Northern Montana College

A4-1. Cash Management

The Current Restricted Fund accounts for federal grants from the U.S. Department of Education (CFDA #s 84.063, 84.033, 84.007, 84.042, 84.116, 84.055) and from the Environmental Protection Agency (EPA) (CFDA #66.418). During the two fiscal years covered by our audit, the college had $50,000 in outstanding inter-entity loans from the Current Operating Fund to the Current Restricted Fund. On the loan authorization forms, college personnel said the loans were needed to pay federal grant expenditures until the college received federal funds to cover these costs.

The college receives funds from the U.S. Department of Education by drawing on a letter of credit. Under the letter of credit agreement, the college may draw funds from a bank as the grant costs are incurred. During fiscal year 1988-89, we found negative cash balances in college accounts for Department of Education grants of $6,622 in July 1988, $19,923 in August 1988, and $91,917 in January 1989. The negative balances indicate college personnel did not draw federal funds on the letter of credit at the time the grant costs were incurred. College management indicated funds were drawn for Department of Education grants at the beginning of each quarter in anticipation of the college's needs for the quarter. The college did not review cash balances again during the quarter. College personnel should monitor cash records and draw cash as needed.

The college receives reimbursements for EPA grant expenditures by a U.S. Treasury check based on expenditure reports submitted to EPA. We observed that the college did not receive reimbursement for fiscal year 1988-89 expenditures related to two EPA grants during the fiscal year. Accounting records showed that the college had charged costs to the grants as early as March 1989. On one grant, college personnel submitted the first expenditure report to EPA in August 1989. We estimated that the college could have requested reimbursement by June 30, 1989 of approximately $30,000 for these two grants. A college official attributed the delayed EPA reimbursements to

expenditure support documentation required by the contract monitor and infrequent submission of grant expenditure reports by college personnel.

We also noted that the contract monitor for the EPA grant denied reimbursement for a $15,445 van purchased by the college in August 1989. The monitor denied the van costs because college personnel omitted written representation from the dealer stating he had abided by standards found in the procurement requirements. As of February 1990, the college had not obtained the assurance from the dealer and had not received reimbursement for the cost of the van.

As a result of the delays in drawing funds from the Department of Education and in requesting reimbursement from EPA, the General Fund lost approximately $737 in investment income in fiscal year 1988-89. The college can decrease the need for inter-entity loans by implementing procedures to ensure more timely draws of federal cash.

Recommendation A4-1

We recommend the college implement procedures to ensure timely draws of federal funds.

Response A4-1

Concur. As of January 1, 1990, we implemented cash management procedures to help ensure federal funds are requested on a timely basis. These procedures include a daily review of cash balances by fund and by accounting entity. Cash balances are also reviewed by grant on a regular basis. Since cash requests are based on estimated expenditures, it is difficult to always request the precise amount of cash needed to make federal grant disbursements. In addition, federal regulations prohibit institutions from having excess federal cash on hand. NMC will strive

to request cash in a timely manner while also not causing the college to have excess cash on hand that would jeopardize federal funding.

A4-2. Equipment Records

The college had approximately $15,461,000 of fixed assets recorded on a fixed asset inventory list at June 30, 1989. The assets include equipment, buildings, and improvements owned by the college. College personnel use the amounts on the list to support amounts reported in the college prepared financial statements. The college purchases some equipment with federal Environmental Protection Agency (CFDA #66.418) funds. To determine the reasonableness of the equipment balance, we selected 15 expenditure transactions coded as purchases of equipment and traced the items purchased to the equipment list to ensure the college recorded the acquisitions at the proper value. Of the purchase transactions tested:

- Nine of fifteen included equipment which was not recorded on the college's equipment list.

- Five of fifteen included items recorded on the equipment list at an incorrect value.

We also noted that the college receives numerous donated items. Many of these items have not been recorded on the college's equipment list. We found automotive equipment such as engines that had been donated by manufacturers among the items not listed. We estimated the value of donated items not recorded on the college's records at $108,211.

State policy requires the college to record fixed assets at original cost on its accounting records if the asset exceeds $1,000 in value. If the asset is acquired by donation, state policy requires the college to record the donation at fair market value on the date the gift was received. In addition to donated items, the college had not deleted equipment from the list that was no longer in use.

According to college personnel, the errors occurred because of the following reasons.

- The computer hardware specialist records computer equipment on a separate equipment listing. However, the computer specialist does not have purchase orders and invoices related to the cost of the equipment. A business office employee uses the list generated by the computer specialist to update the college's equipment records and plugs the value so the system will accept the remainder of the information. This procedure ensures the college assumes accountability for the computer equipment when it is received, but results in the listing of equipment on the inventory at an improper value.

- The accounting clerk responsible for updating the list observed that the list generated to identify equipment purchases does not list accrued expenditures for equipment or subsequent payments on these accruals. NMC purchased in excess of $196,500 in equipment using accrual transactions in the two-year audit period. As a result, the clerk claimed neither the date of receipt nor the actual cost for these items could be determined by reviewing the list of equipment purchases.

- College personnel said the Northern Montana College Development Foundation often sends a copy of the donor receipt to the business office, but the receipt usually does not have a value on it. The official said business office personnel had deferred recording donated assets until all equipment purchased by the college had been added to the property records.

In addition, the college did not conduct a physical inventory in the past two years or adopt standard equipment inventory procedures as recommended in our last audit. State policy requires an agency to conduct a physical inventory of assets annually if a perpetual inventory is not in place and once every two years if a perpetual inventory system is in use. College management should consider inventory procedures that use the knowledge possessed by various employees. For example, those receiving equipment could report it to the property manager in the business office. The computer hardware manager could obtain financial records necessary to value the computer equipment as

it is entered on the records. Receiving reports could be used to facilitate timely recording of fixed assets. Such procedures that allocate the tasks of equipment accountability could enable the college to achieve complete records without a significant increase in the time required of any particular employee.

Recommendation A4-2

We recommend the college:

A. Implement procedures to ensure physical assets are properly recorded on the college records.

B. Conduct a physical inventory of fixed assets in accordance with state policy.

Response A4-2

A. Concur. Northern Montana College is currently working to develop more effective procedures for recording physical assets on inventory records. In the months ahead, our efforts will be to fully implement and maintain the procedures.

B. Concur. Preparations are being made to conduct a physical inventory. We are working to find the adequate human resource time to carry out this task.

A4-3. Accounting Records

Financial information of the college is used by college officials, the Board of Regents, and legislators to manage and establish funding levels for the college. The college uses the Statewide Budgeting and Accounting System (SBAS) to record its financial activity. Section 17-1-102(4), MCA, indicates "all state agencies. . . shall input all necessary transactions to the accounting system. . . before the accounts are closed at the end of the fiscal year in order to present the receipt, use, and disposition of all

money and property for which the agency is accountable in accordance with generally accepted accounting principles (GAAP)."

We noted the following instances where the amounts the college recorded on SBAS did not comply with generally accepted accounting principles.

- The amounts for equipment and library books do not represent actual balances. The college has not updated the equipment on the state's accounting records for several years. As a result, the equipment balance in the Net Investment in Plant Fund on SBAS did not include $1,542,742 in equipment assets shown on the equipment inventory maintained by the college. In addition, the college did not record $1,067,361 in library books on SBAS.

- The college included amounts for completed projects in the Construction Work in Progress account and included amounts already spent on construction in construction advance accounts. Balances in both these accounts should be adjusted to reflect the amounts shown on the project status reports issued by the Department of Administration's Architecture and Engineering Division at fiscal year-end.

  As a result, construction advances were overstated by $25,000 and $44,103 in the Auxiliary and Unexpended Plant Funds, respectively. Construction Work in Progress was overstated by $91,508 in the Unexpended Plant Fund at June 30, 1989. In addition, the college did not record an estimated $110,000 in completed improvements in the Net Investment in Plant Fund.

- The college incurred $16,021 in expenditures for which the college billed EPA (CFDA #66.418) in May 1988. Since the college earned the revenue when it incurred the expenditures, the college should have accrued revenue on the accounting records. As a result, revenue in the Restricted Fund for fiscal year 1987-88 is understated by $16,021.

- The college recorded $4,507 as "fund balance" in the Agency Fund at June 30, 1989. Since the college acts as a trustee for these funds, the college should have recorded this amount as "property held in trust."

- College accounting personnel recorded $45,000 in the Designated Fund for physical plant maintenance inventory at June 30, 1989. The recorded balance for this inventory has not changed since June 30, 1987. The college does not conduct a physical count or maintain records to support the recorded value of this inventory.

College officials attributed the above conditions to human error and turnover in the controller's position. Without all financial activity recorded on the state's accounting records, the quality, consistency, and comparability of the resulting financial information is affected.

<u>Recommendation A4-3</u>

We recommend the college establish procedures to ensure the financial activity is recorded in accordance with state law.

<u>Response A4-3</u>
Concur. All necessary adjustments to the accounting records will be made and we will strive to ensure that all financial activity is properly recorded in the accounting records.

A4-4. Student Wage Rates

The college adopted standard wage classifications and implemented procedures to ensure proper authorization of wage rates paid to student workers, including college work study students (CFDA #84.033). The wage schedules included rates for jobs requiring specialized skills and a range of rates for unskilled jobs based on student tenure at the college. However, student job classification based upon the student having freshmen, sophomore, junior or senior status is a form of pay discrimination and has no relationship to qualifications for or duties of a particular position.

According to a college official, the committee formed to implement the coordination of student employment at the Student

Career Center decided that students with more time on campus should have the opportunity to make higher wages. The college should eliminate the range of rates based on student tenure. The college can implement nondiscriminatory wage rates by paying student workers higher rates based on previous job experience.

Recommendation A4-4

We recommend the college adopt wage rate schedules for student workers based on job skills and experience.

Response A4-4

Concur. The current wage rate schedules were developed to account for job skills and experience. Modifications will be made to the current policy to ensure the objectives of the policy are fully met.

Federal Issues
University of Montana

A5-1.
Federal Financial Assistance

Several federal departments provide financial assistance to the university. These include the U.S. Departments of Education, Agriculture, Defense, Interior and Energy, the National Foundation of Arts and Humanities, the National Science Foundation, the Environmental Protection Agency, and various other federal agencies.

The university participates in three major federal financial assistance programs. These are the Pell Grants, Perkins Loans (formerly National Direct Student Loans) and Stafford Loans (formerly Guaranteed Student Loans). We performed tests to determine the university's compliance with selected federal regulations applicable to major programs. We also performed tests of regulations applicable to some nonmajor federal assistance programs. We identified several concerns which are discussed in the following sections.

A5-1a.
Perkins Loans

The university had approximately 8,500 borrowers and $4.4 million in Perkins Loans (CFDA #84.037 and #84.038) receivables at June 30, 1989. We tested a sample of the outstanding loans at June 30, 1989 which accounted for $41,178 of the total receivable. The following three sections discuss problems found as a result of our testing.

Cumulative Perkins Loans

Federal regulations state the cumulative loans to a student cannot exceed $9,000 for undergraduates with an upper limit of $4,500 during the first two years of study. Federal regulations also place an 18 quarter limit on awards. The limit for graduate students is $18,000, which includes any amounts received as an undergraduate, and an additional 18 quarters.

The university's financial aid office personnel check cumulative loans and quarters to date for University of Montana attendance. Our testing indicated the university does not have written policies and procedures to determine whether transfer students have reached the federal limit on the Perkins Loans. Personnel

indicated it is common practice to check the applications against the federal limits but this review is not documented.

The university has a monitoring obligation which it could meet by implementing a more formal review process. Financial aid officer personnel indicated policies and procedures for the 1990-91 award year are to include directives for reviewing for cumulative loans and quarters.

Transmitting Loan Information

The university contracts with the First Wachovia Student Financial Services, Inc. (Wachovia), which processes Perkins Loans information. University personnel are responsible for data entry while Wachovia processes this data. Wachovia provides several reports to the university including an outstanding loan report which details the amounts owed by each student.

University personnel stated they did not enter any Perkins Loan distributions or changes in enrollment status for the period July 1, 1988 through June 30, 1989 during the fiscal year. University procedures require personnel to complete reconciliations prior to transmitting the financial data to Wachovia to ensure the data is accurate. University personnel stated they did not have time to complete all of the reconciliations.

Federal regulations require the university to exercise due care and diligence in the collection of loans. One of the services Wachovia provides to satisfy this requirement is notification to students when they are in repayment status. It also sends the subsequent billings. The university cannot demonstrate compliance with the "due diligence" regulations for changes occurring during fiscal year 1988-89 since the necessary data had not been transmitted to Wachovia. As of February 1990, personnel had completed transmission of the information for fiscal year 1988-89, according to university officials.

Incorrect Interest Rates

University personnel input information such as name, identification number, loan amount, interest rates, loan dates, etc. onto the Wachovia system. During testing of 18 Perkins loans, we found two instances where the interest rate on the system did

not agree with the interest rate on the promissory note signed by the student. In the first case, Wachovia reported an interest rate of 5 percent, while the note had an interest rate of 4 percent. This student has been placed in repayment status and is paying more in interest than is required by the promissory note. In the second case, Wachovia showed an interest rate of 3 percent, while the note showed a rate of 4 percent. This student has not yet been placed in repayment status. Interest rates recorded on Wachovia should agree with the rates on the promissory notes. Incorrect interest rates on the Wachovia system result in improper interest charges and monthly payment calculations if the error is not detected and corrected. The university conducts exit interviews with students when they indicate they will no longer be in attendance at the university. This is an appropriate time to ensure the correct loan information is recorded on Wachovia. Personnel could use a checklist to ensure all information has been verified.

Controller's office personnel said that in 1981, 1983 and 1987 a university employee compared information on the promissory notes to information recorded on the student loan processing system in use to ensure all information agreed. This review process did detect some differences which were corrected. The interest rate differences we found were both included in at least one of the reviews. Personnel said the errors slipped through the review system.

Recommendation A5-1a

We recommend the university:

A. Monitor cumulative Perkins Loans as required by federal regulations.

B. Transmit Perkins Loans information to the service center on a timely basis.

C. Verify the loan information recorded on the Wachovia system with the promissory notes when a student leaves school and continue its periodic review of loan information recorded on the Wachovia system.

Response A5-1a

A. The university concurs with the recommendation, and will continue to review financial aid transcripts to ensure Perkins loans do not exceed maximum limits.

The Financial Aid Office reviews financial aid transcripts for all transfer or returning students. This information is currently reviewed and now when a student approaches the maximum limits, it will be noted in their file. It is anticipated that this information will be recorded electronically in our student record system which will increase our monitoring capabilities.

B. The university concurs with the recommendation. We are very cognizant of federal regulations requiring the institution to exercise due care and diligence in the collection of loans. Temporary staff has been hired in the loan area to help eliminate backlog so the transmission of loan information will occur in a timely manner.

C. The university concurs with the recommendation. Errors have occurred during the data entry process. We are implementing procedures to ensure accuracy in our initial data entry process. We believe those errors have been identified

and corrected during the student exit interview prior to the time the student begins repayment. We will continue to verify the loan information at that time and will periodically review information on the Wachovia system.

A5-1b.
Student Financial Need

The following paragraphs discuss an issue which may affect all federal student aid programs: Pell Grants (CFDA #84.063), Supplemental Educational Opportunity Grant (CFDA #84.007), State Student Incentive Grant (CFDA #84.069), Perkins Loans (CFDA #84.038), Stafford Loans (CFDA #84.032), and College Work-Study (CFDA #84.033).

We reviewed and tested 45 students' files for documentation of financial need computations. We noted two instances where the financial aid office used improper budgets in figuring the students' financial need. Both errors occurred during fiscal year 1987-88. They resulted in the financial aid office's determination of a smaller than actual financial need. The differences between the budget used and the proper budget were $500 and $5,400, respectively.

In the first instance, the student reported her status as married with four dependents. During the verification process, the student listed herself, her husband, and three dependents. The financial aid office used the application information (one parent, four children) rather than the revised information (two parents, three children).

According to financial aid office personnel, the second instance occurred because the student was a late applicant and applied only for a Pell grant and a Stafford Loan. The budget for a Pell grant is figured differently than those for other programs. As a result, personnel did not recalculate the budget when completing the financial aid portion of the student's Stafford Loan application. The budget used was that for an independent student with no dependents. The financial aid office should have used the budget for a single parent with six children.

Financial aid office personnel indicated an overall reason for the errors was the office was understaffed prior to fiscal year 1987-88. The office obtained additional staff in fiscal year 1987-88. Although the workload per person was reduced, the new staff required training and the benefit of the additional help was fully realized in fiscal year 1988-89.

Recommendation A5-1b

We recommend the university continue to ensure student financial need is calculated in accordance with federal regulations.

Response A5-1b

The University concurs with the recommendation. Compliance with federal regulations is one of the primary goals of the Financial Aid Office. We are continually working at improving the processing methods used in the evaluation of financial aid. A Policies and Procedures manual was first created for the 1987-88 academic year. Since that time, it has been revised and improved for each processing year. These procedures and adequate and stable staff have improved the overall quality of file evaluation.

A5-1c. Untimely Billings and Certified Time and Effort Reports

The university incurred approximately $8.1 million of federal assistance expenditures in fiscal year 1987-88 and $10.4 million in fiscal year 1988-89. As discussed earlier, the university receives its federal assistance from several federal agencies for student financial aid, research grants, and instruction grants. The university obtains moneys via letters of credit, advance receipt by U.S. Treasury check, and direct billings to the federal agency. Letters of credit are used for grants from the U.S. Department of Health and Human Services, the Environmental Protection Agency, the National Science Foundation, and the

U.S. Department of Education. Expenditures from these funds account for $6.2 million in fiscal year 1987-88 and $8.1 million in fiscal year 1988-89.

Prior to fiscal year 1987-88, the university had developed and implemented a grants billing program on its mainframe computer. During July 1987, the university completed implementation of a new accounting system (the College and University Financial System-CUFS). Due to computer hardware changes, the university was no longer able to use its grants billing program. University personnel expected the CUFS grant billing program to be operational within several months after the initial CUFS implementation. Controller's office personnel began processing grant billings by hand when it became evident the CUFS grant billing program was not going to be implemented in time to process fiscal year 1987-88 billings. They continued manual processing throughout fiscal years 1987-88 and 1988-89. The CUFS grant billing system is still not fully operational.

We tested 18 grants for timely billings and found the following 14 grants were not billed in a timely manner during the audit period. The university processed billings for these grants anywhere from eight days to over two years past the scheduled billing dates.

University of Montana
Grants With Untimely Billings

Grant Period	Granting Agency	CFDA #	Name
4/15/87- 5/31/89	USDI-FWS	15.699	Duck Production-Prairie Pothole
6/1/87- 8/31/88	NASA	43.999	NASA Grad Student Research
6/1/88- 6/30/90	USDI-FWS	15.699	Skunk Predation on Duck Nests
5/1/88- 11/8/89	Commerce-NTL Bureau of Standards	11.699	Ignition & Combustion-Lignocell
7/26/88- 11/15/88	USDA-FS-IFRES	10.699	Ecological Studies in Nat'l Areas
10/1/87- 9/30/88	USDI-Geolog. Survey	15.899	Assignment Agree: San Joaquin
7/1/85- 3/31/90	USDI-FWS	15.699	Furbearers Eagles/Ospreys
11/1/87- 10/31/88	Energy-INEL	81.999	Bees Monitor Contaminants at INEL
10/1/86- 3/31/90	NASA	43.999	Conifer Forest-Spacial Scale
10/1/87- 9/30/88	Defense-Air Force	12.999	Malmstrom Teachout-Yr 1
8/15/88- 8/31/90	USDA-Agric. Research	10.001	Pedigree Analysis in Brassicia
10/1/88- 8/31/89	USDI-NPS Glacier	15.999	Glacier Park Wolves
9/1/87- 6/30/89	NASA	43.999	Water & Nitrogen Canopy Process
7/10/87- 4/1/88	USDI-NPS-Glacier	15.999	Glacier Park Limnological Study

In addition to not having a functional grants billing program, the university experienced time delays for grants with a cost share requirement. The university uses "time and effort" to help meet cost share requirements. Time and effort is equivalent to salaries paid from sources other than the particular grants employees are working on. The controller's office distributed all time and effort reports for fiscal year 1987-88 and part of fiscal year 1988-89 to the departments for certification at one time. The departments were not able to certify and return the time and effort reports to the controller's office in a timely manner due to the volume of reports.

The university loaned $1,137,000 from the General Operating Fund to the Restricted Fund to cover negative cash balances in federal grant accounts at fiscal year-end 1987-88. At June 30, 1989, the General Operating Fund covered negative cash balances of $1,118,379 in federal accounts. Many of the university grants are funded on a cost reimbursement basis. The university must bill the grantors or otherwise request the reimbursement. Untimely billings result in the state supporting grant activities longer than is necessary. The average short-term investment pool yield was 7.06 percent in fiscal year 1987-88 and 8.62 percent in fiscal year 1988-89. Using these yields against the loan amounts described here translates into daily interest losses of $220 and $264 for the loans at fiscal year-end 1987-88 and 1988-89, respectively.

The university made an effort during fiscal year 1988-89 to improve the timeliness of billings. The controller's office has taken the following steps to meet the federal grant reporting and billing requirements.

- Added a grant coordinator position.

- Continued development of a grants billing system.

- Distributed workload for grants to accountants more equitably.

- Automated the time and effort reports.

The results of our fieldwork indicate the university is making progress as the billings were more timely for billing periods ending at or near June 30, 1989.

Recommendation A5-1c

We recommend the university:

A. Continue development of a grant billing system.

B. Bill grantor agencies on a timely basis.

Response A5-1c

A. The University concurs with the recommendation, and is in the final testing stage of a grant billing system which will be implemented in fiscal year 1990-91.

B. The University concurs with the recommendation. We have made significant progress in billing grants on a timely basis. We expect to continue that progress with the implementation of the new grant billing system.

Indirect Costs

A5-2.
Indirect Cost Recovery

State law requires all state agencies participating in federal financial assistance programs to recover indirect costs to the fullest extent possible. The university thus negotiates an indirect cost rate each year with the federal government. The university applies this rate to the appropriate direct cost base under the terms of each project agreement. Some federal agencies limit the indirect cost rate allowed to a lower percentage than the negotiated rate. Other federal agencies do not allow recovery of indirect costs. During fiscal year 1988-89 the university accounted for approximately 220 individual grants and collected $532,936 in indirect costs.

The university has a system in place to identify whether a project will pay indirect costs, at what rate, and on what direct cost base. We reviewed eight project files and recalculated the indirect costs charged for fiscal year 1988-89. The university did not correctly calculate indirect costs for three of the eight grants. Two of the projects (U.S. Department of Education, CFDA #84.024 and 84.047 [grant #G00853008402 and #G008640148, respectively]) were undercharged by a total of $72. The other project (U.S. Department of Health and Human Services, CFDA #13.283, grant #U59/CCU8034001) was overcharged by $5,668. In addition, we noted the project under CFDA #84.024 was overbudget by $685. The university processed adjustments during fiscal year 1989-90 to correct these three situations. Therefore, we do not question the allowability of these costs for federal reimbursement. According to university personnel, these errors occurred for the following reasons.

1. University personnel noted the grant (CFDA #84.024) was overbudget by $685 and discontinued the automatic indirect cost charge in August 1989. Controller's office personnel worked with the project personnel and corrected this situation by January 1990.

2. Due to implementation of a new accounting system, university personnel did not charge indirect costs to the grant (CFDA #84.047) for the first three months of the project (July-September 1988). Personnel have indicated the financial records have been adjusted to reflect this additional charge of $69.

3. The project under CFDA #13.283 allowed indirect costs against salaries and wages. However, an accountant inadvertently set the automatic indirect costs collection for total direct costs. This error was discovered and corrected in March 1989 but the overcharge was not corrected until November 1989.

Grant closeout procedures include a step to ensure indirect costs were properly calculated, charged, and billed. The university makes the necessary adjustments prior to final billing. However, the university should also periodically review the

automatic indirect cost settings against the project files. The university should then take steps to ensure noted errors are corrected in a timely manner. These additional procedures would either prevent or detect errors of the types discussed above.

Recommendation A5-2

We recommend the university implement additional procedures to ensure indirect costs are charged according to program guidelines.

Response A5-2

The University concurs, and additional procedures have been implemented by the University to review the indirect cost rate at the time of a first billing. These procedures will ensure errors are detected and corrected.

A6-1. Management Controls

Primary functions of management include organizing, directing, and controlling the activities of an entity in order to accomplish the objectives of the entity. The methods management adopts to carry out these management functions constitute the management control environment.

We noted instances where management control over budgets and compliance with university, state, and federal policies and laws should be improved. The following sections discuss recommendations for strengthening management controls and improving university operations.

Grants and Contracts

The university receives funds from federal, state, and private sources for research, instruction, or other projects conducted by the university. The Grants and Contracts (G&C) Office at Montana State University (MSU), under the direction of the Vice President for Research, oversees projects sponsored by grants or governed by contracts. The G&C Office also controls the indirect cost recoveries received by the university. A coordinator, or principal investigator, heads each project and is responsible for preparing and submitting the project proposal, conducting the research or other project objectives and summarizing and reporting results. The principal investigator assumes the primary responsibility for monitoring the grant progress and compliance with the specific grant agreement when he or she agrees to be the principal investigator for the grant. Because projects are numerous and varied in nature, G&C personnel depend on principal investigators, who are most familiar with projects, to monitor spending for compliance with provisions of contracts and grant agreements.

Total expenditures from all grants and contracts sources were \$14.9 million for fiscal 1987-88 and \$15.7 million for fiscal year 1988-89. Of these amounts, expenditures charged to federal grant projects totaled \$8.7 million in fiscal year 1987-88 and \$8.9 million in fiscal year 1988-89. Grants from the following

federal agencies were the primary federal sources, accounting for expenditures over $1 million each year during the audit period: U.S. Department of Health and Human Services (HHS); U.S. Department of Agriculture (USDA); and National Science Foundation (NSF).

During the audit period, the university's management control system over grant and contract operations was not adequate. The university's grant control system failed to prevent budget overruns, identify unallowable costs, and ensure timely, accurate records of grant expenditures. The control weaknesses discussed in this report in sections A6-1a to A6-1i are cross cutting issues which potentially affect all departments and programs. Although many of the more significant examples of errors and noncompliance occurred within the authority of one campus department, other examples demonstrate the control systems were not operating effectively and did not ensure compliance with laws, regulations, policies, budget restrictions, and specific grant restrictions on a campus wide basis. The following sections discuss specific control weaknesses noted in the grants control system.

A6-1a.
MSU Should Improve Controls to Prevent Budget Overruns

MSU management should improve budgetary controls over grants and contracts. We noted projects had overspent budgets or overspent budget categories specified in grant agreements and contracts. As of June 30, 1989, fourteen projects in eight university departments had budget overruns (cash deficits) totaling $631,690. The overruns ranged from $3,052 to $151,761. At least two of these deficits have existed for more than six years. The university's internal auditor also noted this problem in a May 1989 report involving one department of the university. The internal auditor noted 5 out of 43 G&C accounts for the department had expenditures recorded in excess of the authorized levels. The deficits noted by the internal auditor totaled $191,111 which is included in the $631,690 above.

By spending more than grantors award MSU, principal investigators force the university to absorb extra costs. Agency

personnel suggested deficits might eventually be paid for by using indirect cost recoveries. MSU management needs to implement a formal plan to eliminate the cash deficits caused by overspending in the G&C accounts. In February 1990, we discussed this problem with MSU officials. The Vice President for Research provided documentation that he has plans in place to eliminate $181,875 of the cash deficits during fiscal year 1989-90. This amount will be eliminated using indirect cost recoveries or other sources. $86,802 has been obligated to the G&C debt retirement pool for liquidation during fiscal years 1990-91 and 1991-92 using indirect cost recoveries. According to the Vice President of Research the remaining balance of $363,013 is the responsibility or various departments. The Vice President stated if no solutions or debt retirement plans are provided by the department by the end of fiscal year 1989-90, the remaining deficits will be eliminated during fiscal years 1990-91 and 1991-92 using future indirect cost recoveries.

MSU records such cash deficits as receivables at year-end. The amounts are not valid receivables from sources outside MSU. By recording receivables for the overruns, the university overstated receivables in the restricted fund $596,040 and $631,690 in fiscal years 1987-88 and 1988-89, respectively.

Two of the fourteen projects are federal grants from the National Institute of Health (CFDA #13.867). Costs in excess of the approved grant budget are unallowable costs under federal regulations. Therefore, the cash deficits for these two projects which total $165,782 are questioned costs. Because MSU has not collected the $165,782 from the federal grantor this amount does not represent a potential liability which must be repaid to the federal government. However, costs in excess of approved budgets must be funded from other university sources.

MSU officials may decide the overruns will be paid out of departmental operating budgets in the Unrestricted Fund or through other funding mechanisms such as future indirect cost recoveries as noted above. Once the decision has been made, MSU should move the expenditures to the appropriate fund.

Recommendation A6-1a

We recommend MSU implement a formal plan to eliminate cash deficits caused by overspending in grant and contract accounts.

Response A6-1a

In several instances, MSU has incurred deficits in our grant and contract accounts due to no fault of the institution. In one instance the principal investigator (PI) died during the grant period and could not fulfill the terms and conditions of the grant. As a result of the PI's death the University incurred a $20,972 deficit. In a second instance, the project sponsor instituted bankruptcy proceedings and could not reimburse the institution for our expenditures, resulting in a deficit of $43,931. In a third case, a former faculty member left the University without fulfilling the terms of his contract, resulting in a deficit of $20,263. The University has pursued legal action and will receive periodic $2,500 payments until the full principal is reimbursed. In a fourth account, the deficit occurred when a private company refused to reimburse us in accordance with the contract terms. We are currently pursuing collection on this matter through legal channels.

MSU is very concerned with these deficits, and where possible, has been actively pursuing collection. We also understand that existing resources, such as indirect cost returns, will have to be used to retire these deficits.

Deficits are part of the risk the University assumes when we accept grants and contracts. While the appearance is poor indeed, when put in perspective, they represent less than 1% ($631,690 of approximately $73,000,000) of the total dollar

volume activity during the period. In addition, the University has retired previous deficits and will continue to pursue its plan for deficit retirement.

The Legislative audit report states that these account "deficits" are recorded as "receivables". This is incorrect. Instead, taking a conservative approach based upon a previous OLA audit recommendation, the University sums the negative accounts with the positive accounts, including the cost-reimbursable receivables to determine the net "receivable" balance for financial statement purposes.

The question of "unallowable costs" is a technical audit issue regarding Federal grants and contracts. For the Federal NIH project examples referenced in the audit report, $165,782 are "questioned costs" only because they exceed the grant budgets and are recorded in the grant accounts, <u>not</u> because the nature of the expenditures. Full reimbursement of these two grants has been received at their authorized level and these expenditures do <u>not</u> represent potential liabilities for repayment to the Federal government. The G&C overruns discussed represent University obligations which may be funded from any source determined appropriate by the University administration, just as other overruns in other accounts and fund groups are resolved. Of the $165,782 obligation, all but $58,500 has been resolved and eliminated.

It is important to note that MSU was well aware of the G&C account deficit problems, and that the deficits were not being ignored or hidden. We have been pursuing the deficit account elimination on an informal basis as funds have been available. We have formalized the deficit retirement process in order to monitor and record progress.

We concur, and can document an on-going plan to eliminate cash deficits in grant and contract accounts as resources are available. We have budgeted a FY91 deficit reduction pool of $195,100. This pool is funded by indirect cost returns from those departments responsible for the deficits. We anticipate

continuance of this deficit reduction commitment until all deficits have been retired. Moreover, we will continue to pursue legal action (breach of contracts, bankruptcy, etc.) where appropriate.

**A6-1b.
Budgetary Controls**

Top levels of university management need to be involved to establish responsibility and strengthen budgetary controls. In response to the May 1989 internal audit, department officials stated the department does not have sufficient budget information on a timely basis to keep the principal investigators from overspending. The department officials stated the academic dean or department head have no control or authority over the G&C accounts and thus the department cannot assume responsibility for the deficits. Department officials stated the Vice President for Research and the G&C office were responsible for the deficits.

In February 1990, we discussed budgetary controls with MSU officials. The Vice President for Research noted his frustration in trying to control budget overruns by the principal investigators because he has limited control over the principal investigators. The responsibility and authority to control budget overruns is an issue which management must address. Under current university procedures all grant proposals must be approved by the department head and dean of the college before they are presented to the Vice President for Research. Expenditures and vendor payment authorizations require department approval before being processed by the G&C office. Therefore, the departments share responsibility for budgetary controls. G&C personnel stated the overspending results from the principal investigator's failure to use the budgetary information supplied to them on a routine basis and the principal investigators not monitoring grant expenditures for compliance with authorized budgets. Important budget information, including documentation of expenditures and communications between the principal investigator and the grantor, often does not reach the G&C Office on a timely basis. Examples of untimely information transmitted to the G&C Office include:

1. Equipment totaling $21,198, was ordered by a principal investigator in June 1987 and delivered in August 1987. This equipment was not initially encumbered against the grant (U.S. Department of Education, CFDA #84.031). University officials stated the equipment was originally going to be paid from an account in the Designated Subfund. Department officials determined there was no money available in the Designated Subfund to pay for the equipment. The university did not pay for the equipment until December 1988, when the principal investigator requested the equipment be charged against the grant. The vendor was paid 16 months after the payment was due. MSU incorrectly recorded the December 1988 payment as a fiscal year 1988-89 expenditure. The expenditure should have been recorded as a fiscal year 1987-88 expenditure (August 1987) when the equipment was received. State law, section 17-8-242, MCA, requires an agency to pay bills on a timely basis. In order to promptly pay vendors and ensure expenditures are recorded in the proper year, principal investigators should ensure that equipment purchases and vendor invoices are promptly submitted for payment.

2. A principal investigator received $11,924 of equipment in October 1988 for a federal grant (HHS CFDA #13.999) as part of a larger equipment acquisition. The investigator did not notify the G&C office until September 1989 when the vendor stopped all further credit sales to the university and threatened legal action to collect the past due account. State law, section 17-8-242, MCA, requires an agency to pay bills on a timely basis and provides for interest on past due accounts. The principal investigators' failure to promptly notify the G&C office could result in additional cost to the university for interest on past due accounts. The interest costs if assessed would not be allowable charges to federal grants.

3. A private grant file did not reflect the grantor's revised budget because the principal investigator did not send the information to the G&C Office. When the grant closed, G&C's expenditure records did not support the expenditures on the final report submitted to the grantor. G&C personnel stated the principal investigator prepared the final report, without coordinating with the G&C office.

Without timely and complete information concerning budgets, expenditures and other contractual agreements, G&C personnel

cannot adequately monitor project spending. Incomplete documentation in grant files is discussed later in this report (section A6-1d). University personnel stated principal investigators and their superiors sometimes ignore or override G&C personnel's warnings about budget overruns and requests for additional documentation.

Management has been slow to respond to these warnings of budgetary overruns as evidenced by the $631,690 discussed in section A6-1a. Cash deficits caused by overspending can result in increased use of state General Fund moneys. The university should correct weaknesses in the present budgetary management system and ensure future spending of private, state, and federal grant money complies with applicable budgets.

University officials explained that in order to more closely monitor expenditures the G&C computer system was programmed in fiscal year 1989-90, to stop processing financial activity related to a project when spending approached the budgeted limit. Limiting recorded expenditures to the authorized budget amounts does not address the control problems of investigators exceeding budget unless the limitation is enforced. Management must fix responsibility and strengthen controls to hold the principal investigators accountable for expenditures charged to grants and contracts. Control procedures (some of which are already in place, but not always adhered to) could include: 1) obtaining prior management approval for all major expenditures over a specified dollar amount; 2) requiring principal investigators to provide more timely and complete information to ensure the G&C system presents accurate, up-to-date budgetary information; 3) implementing procedures for the G&C office to monitor and report problems to management; and 4) management taking appropriate disciplinary action to resolve problems. The cooperation and resolve of MSU management and principal investigators is needed to adequately monitor budgets and comply with contractual provisions.

As discussed in the following sections, MSU must also address expenditures without funding sources, improve grant file

documentation, provide for accurate accounting, and comply with state purchasing laws in order to develop adequate administrative and accounting controls over the G&C process.

Recommendation A6-1b

We recommend MSU management:

A. Implement procedures to strengthen budgetary controls over grants and contracts.

B. Establish responsibility for overspending by principal investigators.

C. Require principal investigators to provide more timely information to the Grants and Contracts Office.

D. Monitor expenditures more closely for compliance with the established budgets.

Response A6-1b
Budgetary controls at the departmental level require cooperation and a timely information exchange between the principal investigator, the department head and the research administration. Established internal controls which prevent over-expenditures must be adhered to or they become ineffective. The three examples in the text of the audit report are drawn from the same department referred to throughout the report - a department which hosts one of he finest and most widely recognized teaching and research facilities in the northwest. Unfortunately, in working to develop that facility, numerous internal controls were bypassed, as noted in our May 1989 internal audit report dealing with this department.

Example #1 referenced on page 68 refers to equipment which was requisitioned in April 1987. A purchase order was issued in late June that year, charging the purchase to a designated account fund. The invoice from the vendor was dated August

1987, and the funding source was changed via a memo dated December 8, 1988. The purchasing order was finalized December 15, 1988 and the payment authorization was processed on that date. A clerical error was made in recording the year the payment was made, FY88 rather than FY87. Several factors such as equipment testing and acceptance contributed to the delayed payment to the vendor.

Example #2 represents a partial transaction of a very large and complex purchase agreement. When a major piece of equipment was purchased, a technical addition (5mm probe and support system) was included in the purchase through a sub-contract with another vendor. During the term of the contract, the sub-contractor broke relations with the original vendor and MSU was asked to deal directly with the sub-contractor to obtain the necessary probe. MSU agreed to do this, but noted that the probe must be delivered and tested to ensure that it was satisfactory before payment would be made. The probe was provided to MSU in October 1988, and it was invoiced on March 31, 1989. The probe and system were accepted in early July 1989 after extensive testing, and the payment authorization was received in the MSU Business Office in late August 1989.

Example #3 reflects a difference of $66.24 between recorded and reported expenditures. The sponsor required a specific expenditure reporting format which differed from the State Budgeting and Accounting System (SBAS) format. This meant preparing a report using different expenditure object codes and classifications. We believe that with the exception noted above, the MSU records do support the final report submitted to the sponsoring agency. We received full payment from the sponsor and reimbursed the $66.24 to the sponsor on May 5, 1988.

We concur with A6-1b(A) that we must rigorously enforce compliance with established internal controls through adherence with policies and procedures.

We concur with A6-1b(B) and have supporting written documentation which reflect agreements for responsibility with

principal investigators for any over-expenditures. We are formalizing the financial responsibility for G&C account deficits among the various levels of the University organization to reflect the organizational structure. The departments responsible for grant and contract deficits are being held accountable and the departmental indirect cost returns are being used to resolve those deficits. MSU has also contracted with a team of consultants to review financial responsibilities, and recommend policies and procedures which are appropriate to ensure good internal control.

We concur with A6-1b(C) and have long pressed for timely and accurate information from the principal investigators. However, we find it extremely difficult to <u>force</u> this issue, particularly when vendors are complaining about unpaid invoices and the principal investigators are complaining about sub-standard equipment and unfulfilled purchase orders. We believe that it is in the best interests of the State to only obtain and pay for equipment which meets the needs and standards of the investigator, in accordance with the terms and conditions of the purchase orders.

We concur with A6-1b(D) and have implemented several internal controls which will flag expenditure requisitions for approval and for funding needs, as well as reviewing and freezing those accounts where the expenditures and encumbrances have approached 95% of the authorized project level.

**A6-1c.
Expenditures Without Funding Sources**

MSU spent money for projects although funding was not yet available or the source was not yet known. Incurring expenditures prior to obtaining a specific funding source contributes to the budgetary and cash deficit problems previously discussed in sections A6-1a and A6-1b. The following examples were noted during our audit.

1. MSU spent $16,281 of restricted funds as a federal grant expenditure although MSU does not have a federal grant award for the money (NSF CFDA #47.999). Agency personnel said they received a verbal commitment and

authorization to exercise pre-award expenditures from an existing G&C account for $20,000 from the National Science Foundation in 1988, but as of October 1989 have received no written award yet. Since MSU has no contract for the funding, the project expenditures of $16,281 increase the cash deficit in the G&C accounts and are a potential Unrestricted Fund cost to the university if the anticipated grantor does not formally award the funds to MSU. If the university had pre-award authorization for these expenditures the university should have either recorded the expenditures under the existing account or transferred $20,000 authority from the existing account to the new project. By not recording expenditure with the related authority MSU increases the potential for expenditures to exceed amounts authorized by the grantor.

2. In September 1987 MSU officials agreed to finance the $130,000 renovation of a laboratory for a newly hired professor. Under the terms of the renovation agreement the G&C office established an $80,000 budget funded from designated fund indirect cost recoveries earned in fiscal year 1987-88 and the professor's department was to provide the remaining $50,000 over a three year period. As of September 1989, expenditures for the renovation project totaled approximately $105,400. However, the department did not have any funds available for amounts over the $80,000 provided by the G&C Office. As a result, a $35,145 contractor payment was paid out of the Physical Plant budget in the unrestricted fund. This reduced the funds available for planned maintenance projects.

   University officials explained in February 1990 that this project should have been accounted for in the Plant Funds rather than the designated G&C account. The officials stated the department is still responsible for expenditures in excess of the $80,000 budget in the G&C account. Officials anticipate correcting the department expenditures during the current fiscal year.

3. The university maintains a "mini rentals" account in the designated fund. The account is administered by the Vice President for Research. The mini rentals account is used to pay faculty start up costs, reimburse the MSU Foundation for equipment purchased on behalf of MSU, and in some instances, pay for equipment purchased by MSU for various departments. The mini rentals account is supposed to be reimbursed with regular payments by the department

receiving the equipment. At the time the equipment is acquired, the department heads make a commitment for regular payments. However, some departments have been unable to meet those commitments. During the audit period the mini rentals account consistently operated with a deficit cash balance. The cash deficits were $124,135 at fiscal year-end 1987, $131,681 at fiscal year-end 1988, and $167,665 at fiscal year-end 1989. Officials explained $90,000 of the 1989 deficit was for a faculty start up equipment purchase. The Vice President for Research must find other methods to eliminate the cash deficits. Officials stated they intend to use indirect cost recoveries on future grants. University officials said they discontinued use of the mini rentals account as of September, 1989, and said they will not allow any additional equipment acquisitions until the deficits have been eliminated.

University officials should ensure there is a reliable funding mechanism available before making payment commitments in the G&C accounts.

Recommendation A6-1c

We recommend MSU obtain written documentation of grant awards and secure funding sources before expending funds for grants and contracts projects.

Response A6-1c

Example #1 in the OLA audit report does not accurately reflect the activity which took place. The expenditure of $16,281 was based upon verbal commitments made prior to receipt of the written award notice. Receiving verbal commitments to authorize pre-awards expenditures are relatively common in G&C. In this particular case, MSU was requested to host a symposium on the fires in Yellowstone Park. The National Science Foundation (NSF) and other sponsors wanted the symposium held expeditiously in order to facilitate gathering critical data before winter, and thus, the pre-award expenditures were authorized. On October 11, 1988, a new G&C account was established for

the $5000 received from one sponsor, and the receipt of an additional $27,500 from other sponsors was pending. These additional verbal commitments met MSU's requirements for establishing this account. The National Science Foundation formally awarded $20,000 on April 19, 1989, through an existing NSF grant.

The NSF and other agencies have formal guidelines for pre-award expenditures using the Organizational Prior Approval System (OPAS). In order to use OPAS, as authorization by NSF, the following must occur:

A) there must be a written request from the principal investigator for authorization to proceed,

B) the principal investigator must obtain the name, address, and telephone number of the sponsoring agency representative or program director,

C) the institutional research committee must review the potential commitment to the department and principal investigator if the award does not materialize, for whatever reason,

D) the institutional research committee must obtain a verbal commitment from the sponsoring agency,

E) the institutional research committee members must discuss the situation and either approve or deny the action, and

F) upon approval by the institutional research committee, the project is established and the principal investigator is advised in writing that their department accepts the potential liability for expenditures if the award does not materialize for whatever reason.

Example #2 from the OLA audit report also inaccurately portrays the events regarding the remodeling of a new professor's laboratory. The $80,000 from existing indirect cost recoveries

was committed by the University, and an agreement was signed to allow an additional $50,000 commitment from departmental funds and/or from the professor's anticipated G&C project indirect cost recoveries.

The bill for $35,145 was paid by the Physical Plant as a means of immediately satisfying the vendor. For whatever reason, payment for two previous invoices had been delayed, and MSU chose to pay the vendor immediately. It was our intent to correct the expenditure as soon as the appropriate accounts were identified. MSU has made the expenditure correction to the proper G&C account.

Example #3 from the OLA audit report referencing the "mini-rental" designated account contained only one unfunded user agreement payment as of June 30, 1989. The unfunded payment has been made by the department responsible. The remainder of the balance in the account provided a faculty start-up package and equipped a laboratory facility. Using departmental indirect cost returns, $14,611 has been paid to the "mini-rental" account this fiscal year and the remainder is budgeted for repayment over the next three years. The account has been used primarily to record collections of user fees which are transmitted periodically to the MSU Foundation, as discussed later in this response.

We partially concur with this recommendation, as it is standard practice to obtain verbal rather than written notification of grant awards which allows MSU to exercise the pre-award expenditure option in order to execute obligations in a timely manner. To wait until written authorization is received would severely hamper critical research efforts where the immediate collection of data or conduct of business is of the utmost importance. We will, however, provide better file documentation for an audit trail when verbal awards are offered and accepted.

A6-1d.
Grant File Documentation

We noted a need for improved documentation in some of the grant files we reviewed. Specific examples of problems caused by inadequate documentation are discussed in the following paragraphs.

1. MSU received a $920,000 grant from the U.S. Department of Education (CFDA #84.031) in 1987 for a chemical research computer network. The grant requires a 50 percent ($460,000) cost sharing by the university. The total federal share of expenditures charged to this grant are $451,171 as of October 1989. This grant is a cost reimbursable contract which provides for the university to obtain reimbursement for expenditures incurred. However, due to documentation problems from May 1987 through December 1988, this project incurred a cash deficit of $395,971.

   Included in the $395,971 is a $100,000 cash transfer to the "global computing" account. The global computing account is for a $2.4 million upgrade of the university's central computer system. During the audit, the grant files did not document the equipment acquired with this transfer nor how this transaction related to the overall scope of the approved grant proposal as required by federal regulations. Because of the documentation problems the $100,000 is a questioned cost for this grant.

   In addition, as of October 1989 the university had not billed the grantor for the majority of expenditures because it could not document the cost sharing portion of the grant. Assuming the university eventually is able to document its cost sharing, and bills the grantor, lost interest on charges not billed is approximately $54,450 to date. Each month's delay in billing results in an additional $2,636 in lost interest. Until the university documents compliance with provisions of this grant, the entire $451,171 of expenditures is a questioned cost.

2. A grant from the National Science Foundation (CFDA #47.999) for $170,000 required MSU to provide matching state or private funds of $85,000 toward the purchase of research equipment. G&C officials stated they were not aware of the required match. The file did not document the matching expenditures requirement. We contacted the grantor and obtained documentation that the principal investigator of the project had approved the matching requirement in writing.

> The federal grantor in this case could disallow the $170,000 of grant expenditures based on failure to provide matching funds and adequately document matching expenditures as required by federal regulations. As noted in section A6-1g, we also questioned the $170,000 for failure to comply with state purchasing laws.

These problems resulted from incomplete information supplied to the G&C Office by principal investigators and a lack of compliance with procedures in the G&C system for tracking matching and cost sharing expenditures. Without complete information, MSU's G&C system cannot adequately monitor spending to ensure compliance with contractual agreements and state and federal laws and regulations. Inability to provide adequate documentation of grant activity may cause federal, state, and private grantors to disallow grant expenditures, resulting in potential losses to the university and the state.

<u>Recommendation A6-1d</u>

We recommend MSU:

A. Strengthen procedures to track matching and cost sharing expenditures in grant records of the Grants and Contracts Office to ensure grant requirements are met; and

B. Improve documentation of grant activity in the grant control system.

<u>Response A6-1d</u>

The examples used were again from the department previously referenced. MSU recognizes the need to carefully and fully document grant files, but takes exception to the statement in example #1 that the $100,000 is a "questioned cost." The documentation for this expenditure of funds was not centralized at the time of the audit, but was fully supported with written

narrative. Essentially, the funds were used to network chemistry computing equipment with other computing resources.

Billing for this project was submitted to the sponsoring agency periodically, but reimbursement was refused until the equipment was tested and approved, and the support documentation was provided. The final project billing was submitted to the sponsoring agency on January 24, 1990, a subsequent facility site visit was conducted, and the facility was approved by the sponsor.

In reference to example #2, it is important to note that MSU had submitted the final report and billing for reimbursement and the file had been closed subsequent to the audit. The matching documentation has been provided to the sponsoring agency.

We concur with both A6-1d (A&B) and will take the necessary steps to more carefully document the grant files, and track and record the matching expenditures in accordance with our existing procedures.

A6-1e.
Accurate Records

The university accounting system generates automatic billings to projects for items requested or utilized by the principal investigators. We found object coding problems with Chemistry Stores automatic billings. Chemistry Stores purchases items for resale and charges departmental customers, including grant and contract projects, through MSU's automatic billing system. The information prepared by the Chemistry Stores billing clerk and input to the automated billing system did not accurately classify the type or object of expenditures for Chemistry Store transactions.

For example, one federal grant project had at least $37,565 of equipment purchased from Chemistry Stores coded as "supplies." The items included a $6,176 freezer and an $11,525 laser. In addition to the equipment purchased through Chemistry Stores, the grant records reflect an additional $4,093 of equipment purchases. The grant had no equipment budget authorized by

the grantor, so the purchases were not an allowable expenditure under the grant. Therefore, we question $41,658 of equipment costs for this grant (HHS CFDA #13.867, grant #7R01-EYO6913-01). A similar grant purchased at least $25,038 of equipment from Chemistry Stores which was reported as "supplies." The grant records reflect an additional equipment cost of $7,922. Therefore, the total equipment costs in this grant are $32,960. However, the grant award only allowed for $1,710 of equipment. We question $31,250 of equipment costs which exceed the budget amounts for this grant (CFDA #13.867, grant #7R01-EY06914-01).

Misclassified or inaccurately classified costs distort grant records and result in inaccurate expenditure information being reported to the grantor. Because equipment purchases are recorded as supplies, G&C personnel said they are unable to determine the nature of many charges to grant accounts made through automatic billing procedures for Chemistry Stores. If the costs were properly classified, the G&C office could use the information to determine if the costs are allowable under the grant agreements.

In addition to misclassified costs, we noted other concerns with Chemistry Stores' transactions. The internal auditor also noted these concerns in May 1989. The function of Chemistry Stores is to obtain and provide chemicals and related supplies used by the Chemistry Department or other departments. By obtaining equipment for resale, Chemistry Stores unnecessarily duplicates a service already provided by the MSU Purchasing Department. Chemistry Stores' current method of pricing and recording equipment purchases weakens MSU's controls over spending grant moneys in compliance with grant agreements.

Chemistry Stores in some cases, adds a ten to twelve percent markup to the cost of equipment. The markup is not consistently applied to all equipment purchases made through Chemistry Stores. Out of 42 individual purchases examined, only 25 items included any markup. We determined there was a total of $2,624 in markups for the two grants discussed in the previous paragraphs (HHS CFDA #13.867). The cost of

equipment items purchased through Chemistry Stores, therefore, may exceed the cost which would result if the MSU Purchasing Department provided the items. The Purchasing Department does not use markups. The internal auditor noted a need exists to develop a consistent markup policy for Chemistry Stores. Federal regulations specifically allow only actual costs and require the university to treat costs consistently. Because the markups are not actual costs and because the markups are not applied consistently, they are unallowable charges to federal grants. We could not estimate the total questioned costs to federal grants caused by the markups.

In a May 1989 report, MSU's internal auditor noted other related items concerning the Chemistry Stores' operations. Concerns noted by the internal auditor include:

1. Expenditures have consistently exceeded revenues since 1984.

2. A lack of knowledge about and use of standard business procedures in the operation of Chemistry Stores.

3. Expenditure of Chemistry Stores' funds for support and operations of the chemistry department including $72,000 of equipment for the Department.

Because of the concerns noted by the internal auditor and because Chemistry Stores duplicates certain services provided by the Purchasing Department, university management should reevaluate the role of Chemistry Stores' equipment purchases in order to improve management controls and efficiency.

<u>Recommendation A6-1e</u>

We recommend MSU:

A. **Review procedures to ensure automatic billings correctly classify expenditures in the accounting records.**

B. **Review automatic billings to grant projects to identify instances of unallowable equipment purchases or markups.**

C. **Charge only actual costs for equipment purchases billed to grant projects.**

D. **Reevaluate the role of Chemistry Stores equipment purchases.**

<u>Response A6-1e</u>
Again, it is important to note that the examples provided in the OLA audit report were drawn specifically from the department identified previously.

We concur with A6-1e(A) and have directed Chemistry Stores to refer all purchases for other than chemistry supplies to the MSU Purchasing Department. The automatic billing system will appropriately object code all sales through Chemistry Stores as supply expenditures.

We do not concur with A6-1e(B), as it would be an inappropriate use of staff time to review supply purchases paid for through the automatic billing function. No University automatic billing entities are allowed to purchase equipment for resale as Chemistry Stores was doing.

We believe that the principal investigators must be responsible for making purchases which are in accordance with the grant or contract terms. As a means of strengthening our internal control system, we are having a consultant prepare a written procedures guide for principal investigators.

We concur with A6-1e(C) and have recognized that this is an important Federal compliance issue. Re-directing the purchasing responsibility to our Purchasing Department will ensure that we are in compliance.

We concur with A6-1e(D) and have directed Chemistry Stores to cease purchasing equipment for re-sale. In addition, because of numerous problems with Chemistry Stores, we have re-assigned the responsibility for Chemistry Stores management from the academic department to an administrative department.

A6-1f.
Cash Management

The university receives grant funds through cash requests (drawdowns) and reimbursement billings. Because drawdowns and billings are predominantly on a reimbursement basis and are requested on a monthly or longer basis, the time lag between an expenditure and subsequent reimbursement requires the use of state funds. As noted in our two prior audits, MSU does not request funds from grantors often enough to ensure the most efficient use of state funds. We estimated the monthly balance of grant expenditures pending reimbursement averaged \$1,250,573 during fiscal year 1987-88 and \$2,081,600 during fiscal year 1988-89. The following illustrates the estimated lost investment income on state funds pending reimbursement for the last six years.

	Fiscal Year	Estimated Lost Investment Income
Current Audit	1988-89	$141,341
" "	1987-88	84,914
Prior Audits	1986-87	42,119
" "	1985-86	23,845
" "	1984-85	50,000
" "	1983-84	50,000
Six Year Total		$392,219

Source: Prepared by the Office of the Legislative Auditor

In each of our two prior audits we recommended MSU request moneys in a manner which would minimize the necessity for the state funds to advance cash to grant programs. MSU concurred with both of our prior recommendations and in response to the recommendation in our audit for the two fiscal years ended June 30, 1985, MSU changed the timing of the request for reimbursement. Previously the university's requests were made at the end of the month but prior to the payroll costs being paid. The university altered the timing of the requests so they were made after the payroll was paid. This helped reduce the time lag and temporarily reduced the lost investment income amount as shown above. However, MSU has not fully implemented the prior cash management recommendation. Addressing the problems previously discussed in sections A6-1a through A6-1d could also lead to more timely billing on some projects and reduce the lost investment income.

Federal regulations allow the recipient to make drawdowns as close as possible to the time of making disbursements. Section 17-2-108, MCA, requires agencies to use non-General Fund moneys wherever possible before using General Fund moneys.

These federal and state regulations provide for the use of frequent drawdowns in order to minimize lost investment income to the state on state funds or to the federal government on federal funds.

Grants and Contracts Office personnel said lack of sufficient personnel prohibits more frequent requests for funds in most cases. The G&C Administrator stated he plans to hire one additional staff at approximately $16,500 to $18,000 per year to alleviate the billing problem. A Student Financial Aid Office employee said he could monitor more carefully and request funds more frequently from the grantor if he chose to do so; however, he said he intentionally keeps federal cash balances low at the end of academic quarters to ensure they do not have excessive cash on hand for quarterly federal reports.

MSU could draw on grants received via wire transfer letters of credit, such as the student financial aid funds from the U.S. Department of Education, as frequently as every three days. The university should concentrate efforts for more frequent billings on high dollar grants in order to minimize the use of state funds. Such requests would more effectively minimize cash on hand while reducing negative account balances and increasing investment income for the state.

Recommendation A6-1f

We recommend MSU monitor cash balances and request grant moneys in a manner which minimizes the necessity for the state funds to advance cash to grant programs.

Response A6-1f

Upon reviewing the increasing level of State funds used to temporarily support grant activity on page 85 of the OLA audit report, the reader must also recognize that grant and contract activity at MSU has grown dramatically from an FY84 total of

$9,067,789 to an FY89 total of $15,775,928. We are projecting an FY90 total of $17,400,000. The vast majority of G&C contracts are cost reimbursable, and the temporary use of State funds is a cost of participating in this type of G&C funded activity. Cost reimbursement is governed by the terms of the grant contract.

MSU has taken steps to decrease reliance on advanced State funds for grant programs. The audit report refers to the ordering of reimbursement funds after the monthly payroll as one major step in better cash management. In addition, MSU has significantly increased the number of contracts which allow monthly billing for reimbursements, though we must still abide by the billing terms of the contract. Wire transfers are utilized to avoid delays with the reimbursements, and requisitions must be approved by the G&C administration, which also allows Federal funds to be ordered in anticipation of the receipt of major equipment.

Delayed payment for cost reimbursable grants and contracts with other State agencies also contributes to our cash management problems. In excess of 12% ($235,270) of our receivables balance for the month of March 1990 is due to unpaid billings over 30 days old from other State agencies, including Office of Public Instruction, Department of Natural Resources and Conservation, Department of Health and Environmental Sciences, Department of Fish, Wildlife and Parks, Department of Highways, and Department of Agriculture.

We concur with this recommendation and are making every reasonable effort to reduce lost interest income on State funds and still comply with Federal regulations. It should be noted that past Federal audit reports were critical of MSU for maintaining any Federal cash balances. It is impossible to not incur deficits in State funds without maintaining cash balances of Federal funds. MSU is thus placed in a compromised position where resolution to the satisfaction of all parties is available only through instantaneous cash transfers as expenditures occur. MSU will seek to address this conflict, possibly through a

change in State Statute as was done for the Department of Social and Rehabilitation Services and the Department of Highways.

Purchasing Controls

We identified several violations of university, state, and federal purchasing policies and state purchasing laws related to grant and nongrant expenditures. Management should strengthen its controls over purchasing to avoid violations of laws and policies such as those discussed in the following paragraphs.

A6-1g.
Compliance with State Purchasing Laws

In October 1987, a university professor ordered two special purpose research instruments costing a total of $747,000. The purchase of these instruments did not go through state or university purchasing procedures as required by state law and federal regulations. Although the professor did contact and obtain proposals from several vendors, the process did not comply with the competitive, sealed bidding requirements of state law. MSU's agreement with the State Purchasing Division, Department of Administration, requires research equipment costing more than $10,000 be acquired through the State Purchasing Division. There was no approved requisition or purchase order.

University officials stated these purchases were obtained through a "use agreement" with the MSU Foundation. A "use agreement" is a funding mechanism where the university enters into a formal agreement with the Foundation to acquire equipment. The Foundation purchases the equipment and the university agrees to make periodic payments including interest to reimburse the Foundation. The agreement specifies the equipment to be purchased and the payment terms. We noted there was no formal use agreement covering these purchases. The Foundation wrote a check to the vendor and the same day the university wrote a contingent revolving check to reimburse the Foundation. The university recorded the check to the Foundation as "rent" instead of "equipment." Because the Foundation received payment in full from MSU and paid the vendor the same day, "rent" is not the correct expenditure classification. In a May 1989 report, the internal auditor also noted this

transaction ". . . is misleading, as there was coding error when . . . expenditures were coded as 'rental' rather than 'capital equipment' . . ." This is another example of the misclassification of costs, similar to instances discussed in section A6-1e. The involvement of the Foundation does not alter the substance of the transaction as a purchase by the university. MSU officials ordered the equipment and fully paid for the equipment; therefore, the transaction was a purchase by MSU and should have followed state purchasing laws.

Circumventing state purchasing laws and misclassifying the expenditure on the accounting records constitute a significant problem which indicates the inability of MSU's current management control system to prevent or detect similar problems in the future. MSU needs to implement controls to address this problem.

Because the equipment purchases did not follow established university policies and state law, the costs are not allowable per federal regulations (OMB Circular A-21). Accordingly, we question $547,000 of equipment charges to the following federal grants:

$170,000 of a National Science Foundation grant (CFDA #47.999)

$300,000 of a Health & Human Services grant (CFDA #13.999)

$77,000 of a Department of Education grant (CFDA #84.031)

The remaining $200,000 was charged to a private grant.

Recommendation A6-1g

We recommend MSU comply with state purchasing laws for equipment acquisitions.

Response A6-1g

We concur with this recommendation, not only for the purchase of equipment, but for all purchases. In 1981, MSU established a formal agreement, policies, and procedures with the MSU Foundation to allow "on behalf of financing" through the user agreements. This legal arrangement allowed MSU to make a formal request to the Foundation for capital equipment, the Foundation purchased the desired equipment using their funding, and the department which made the request then paid a period charge based upon actual use of the equipment. This procedure called for payments for the use of the equipment until the Foundation recaptured all of its costs of purchasing and providing the equipment. The IRS Codes required the Foundation to gift the equipment to MSU at that time, and MSU recorded the gift at fair market value.

In a single instance concerning the department previously identified, the procedures which govern the use of this agreement were breached. Though MSU recognizes the use agreement as an accepted method of procurement for capital equipment, the purchaser must adhere to the procedures set forth in the MSU/Foundation agreement, or the purchase takes on other appearances which may not be appropriate or recognized by MSU. Because it was MSU's intent to provide equipment using this legal, recognized, and accepted means of procurement, the grant proposals and subsequent correspondence with the sponsors relate how the purchases were to occur. To confirm that we are in compliance with the terms and conditions of the contracts, MSU has written to each of the Federal sponsors and asked for re-confirmation of this specific issue.

A6-1h.
Already Received Purchase Requisitions

We noted extensive use of "Already Received Purchase Requisitions" (ARPR) during the audit period. During a seven month period in fiscal year 1988-89, MSU processed over 1,000 ARPRs on printed forms provided for this purpose. Of approximately 400 ARPRs we reviewed, we found at least 43 cases which were obviously not emergencies. University policy permits use of ARPRs if the purchase results from a "situation or occurrence of a serious nature, developing suddenly and unexpectedly, and demanding immediate action." Many of ARPRs we reviewed did not meet that criterion. In addition, many of the ARPRs we reviewed were also explained as sole source purchases, meaning only one vendor could supply the item. State policy requires the agency to approve sole source requisitions and justifications before acquiring the items. This is not the case with ARPRs. The item is purchased and the paper work and approval is after the fact. In addition, state policy specifies that exigency purchases (i.e., emergency, requiring immediate action) shall be limited to those supplies necessary to meet the exigency and should be based on extreme need. Typical justifications for ARPR use included the following.

- Purchase of a portable lap top computer for $1,428 to finish a report by the deadline (HHS CFDA #13.867). The principal investigator justified the purchase by stating his travel expense would not have been reimbursed for a meeting he attended if the report was not submitted on time. He also explained that he traveled a lot on university business and he could make more efficient use of his time using the computer. The computer was purchased in October 1988 but the paper work was not submitted until April 1989.

- Purchase of two disc drives totaling $1,840 for part of a traveling exhibit. The exhibit was to open in July 1989. The equipment was purchased in June 1989. The justification said there was no time to obtain a purchase order. However, the file indicated that the department considered acquiring this equipment in April 1989.

- Purchase of 50 calculators for $1,019. The justification stated in order to do the demonstration right away, the calculators needed to be purchased immediately. It stated there was not time to do a purchase order. The instructor

responsible for the demonstration should have been aware of her work schedule and could have avoided using an ARPR by more advance planning and anticipating project needs and time frames.

Based on our review, many of the "emergency" situations could have been avoided by planning on the part of university personnel. These and other examples indicate that ARPRs were being used to justify and document purchases which circumvented the normal purchasing procedures of the university. Improper use of ARPRs undermines MSU's purchasing control system. By allowing misuse of ARPRs for federal grant purchases, MSU violates federal procurement regulations which require the university to follow established purchasing policies. The improper purchases are questioned costs under federal regulations.

The problem of ARPR misuse was addressed in reports by the Montana Department of Administration Purchasing Division in March 1988 and by MSU's internal auditor in May 1989. We also discussed problems with sole source and emergency purchase orders in a performance audit in May 1980.

Recommendation A6-1h

We recommend MSU management limit the use of already received purchase requisitions and exigency purchases to emergency situations as required by state policy.

Response A6-1h

We concur and have taken steps to more closely monitor such use on a campus wide basis. A task force has been established to review use of Already Received Purchase Requisitions (ARPR's), and directives have between issued to certain departments advising them that ARPR's will not be allowed except for true emergencies. We already have or will be implementing the following internal controls: 1) requiring departments to improve their justification for the use of ARPR's; 2) re-designing the

ARPR form so that it is very clear that such use is to be only for emergencies; 3) advising those who authorize ARPR's that approval must be based upon the need to address a true emergency; and 4) working administratively with those departments which appear to be abusing the use of ARPR's by utilizing other available alternatives for frequent purchases of an unknown nature or quantity. Those who do not abide will be forced to return the goods and settle with the vendor. We believe that there is a need for legitimate ARPR's, and are willing to abide by the procedures governing their use.

A6-1i.
Summary

As noted in the preceding sections, management controls need improvement at the university. The controls were not operating as originally designed. Given the seriousness of the control problems noted with the G&C system and the magnitude of the questioned costs noted in this report, future funding for federal grants could be in jeopardy. In addition, the federal resolution of questioned costs could result in MSU having to refund questioned costs to the grantors. Refunding questioned costs could impact future budgets and impair MSU's ability to maintain its level of operations.

Total expenditures processed by the G&C system and charged to federal grant projects was $8.7 million in fiscal year 1987-88 and $8.9 million in fiscal year 1988-89. Of these amounts our audit disclosed the following questioned costs:

> $165,782 because MSU exceeded the project budgets. See section A6-1a.
>
> $451,171 because MSU did not document the required cost sharing in compliance with the grant. See section A6-1d.
>
> $547,000 of equipment expenditures because MSU did not comply with state purchasing laws. Of this amount, $77,000 is included in the $451,171 above. See section A6-1g.
>
> $16,281 because MSU did not have a grant award. See section A6-1c.

$72,908 because the equipment expenditures are misclassified as supplies and the expenditures exceed the approved budget amounts. See section A6-1e.

$13,352 because the items were acquired with "already received purchase requisitions" and did not comply with state purchasing laws. See sections A6-1b. and A6-1h.

Not all of these costs have been billed and collected from grantors. Of the total $1,189,494 questioned costs noted above, MSU had not billed or collected $578,034 as of October 1989.

Due to the significance of the control problems noted we are unable to provide assurance to the federal grantors that the university control systems are adequate to ensure compliance with terms and conditions of federal programs.

Recommendation A6-1i

We recommend MSU management control grant and contract expenditures and ensure compliance with contractual agreements.

Response A6-1i

We concur with this recommendation, as noted in Response No. A6-1b, and are taking the appropriate and necessary steps to better ensure that activities are in compliance with already-established policies and procedures. Where necessary, internal controls are being strengthened through the development of additional procedures, and oversight of activities is being increased as needed.

A6-2. Accounting Issues

The following report sections detail items where MSU financial administration did not detect errors on the university's accounting system.

A6-2a. Recording Revenue in the Proper Fund

We found two instances where the university recorded revenue in the wrong fund.

1. Revenue received on "fixed price" contracts above the costs (profits) associated with the performance of the contract should be recorded in the unrestricted fund. MSU leaves the excess money in the Restricted Fund where the revenue is initially recorded. When the funds are no longer restricted by an outside source, any profits should be accounted for in the Unrestricted Operating or Designated Fund. We estimate a total of not more than $60,000 is recorded in the wrong fund.

   The issue of fixed price contract profits being recorded in the wrong fund was addressed in the previous audit. MSU did not concur with the prior audit recommendation. MSU personnel expressed concern that if the remaining funds are moved out of the Restricted Fund it may reduce the incentive for principal investigators to complete projects in an efficient manner. Recording the profits in the unrestricted accounts would improve the university's reporting in compliance with generally accepted accounting principles, while maintaining management's incentives for efficiency and flexibility.

2. In fiscal year 1988-89 the Pell grant (CFDA #84.063) administrative cost allowance of $18,415 was recorded as revenue in the Restricted Fund. The administrative cost allowance is given to the university based on a flat fee of five dollars per Pell grant application. The university can use the money at its discretion to support its operations. Generally accepted accounting principles (GAAP) requires the administrative cost allowance be recorded in the Current Unrestricted Operating Fund. MSU officials stated the wrong account number was used when making the deposit.

Recommendation A6-2a

We recommend MSU record profits from fixed price contracts and administrative cost allowances in the Unrestricted Fund.

Response A6-2a
We concur with this recommendation and are developing procedures to identify the few fixed price contracts which are administered annually and which are completed at less than contract price so that the residual funds can be recorded in the designated Unrestricted Fund.

The cash receipt for the largest single deposit of administrative cost allowances ($17,940) designated the deposit to the General Operations unrestricted account. However, the wrong account number was used by MSU. This deposit has been corrected in the accounting records. While it is difficult to prevent human error, in the future, SBAS reports will be referenced by the MSU Financial Aid administration to ensure that deposits are credited to the proper account.

A6-2b.
Use Agreements

Over the years MSU has entered into use agreements with the MSU Foundation. The Foundation purchased equipment items that MSU departments needed for classroom and research projects. The departments were required to make periodic payments to the Foundation for the use of the equipment. When payments were complete the Foundation would transfer title of the equipment to the university.

The use agreements are not correctly accounted for on the university's property and accounting system. As discussed in section A6-1g, the university improperly recorded the payments as "rent" instead of "equipment." Equipment purchased through the Foundation should not be recorded as rent expense. Under state policy and generally accepted accounting principles, the substance of the use agreements meets the criteria for

classification as a capital lease. Capital leases should be accounted for as follows:

1. Capitalize the equipment at the inception of the lease.

2. Establish the liability (lease payable) for the debt.

3. Reduce the lease payable balance after each periodic payment.

At June 30, 1989 approximately $80,160 of liability remains on two outstanding use agreements. This liability is not recorded on the accounting records. MSU personnel indicated they were considering alternate methods of acquiring equipment in the future rather than use agreements with the Foundation. If MSU does enter into any future use agreements, the acquisitions should be accounted for as capital leases.

Recommendation A6-2b

We recommend MSU account for capital leases in accordance with generally accepted accounting principles.

Response A6-2b
We believe that if the terms of the User Agreements are followed, that they do not constitute a capital lease. Varying levels of payment are made over a period not to exceed three years, and there is no recorded liability since the MSU Foundation is responsible for the equipment in the event of default on payment. In accordance with GAAP, the fair market value of the equipment is recorded at the time the equipment is gifted to MSU.

We concur with this recommendation and annually report such agreements as required. All User Agreements have been fulfilled by MSU and if this system is a problem, alternative methods of acquiring future capital equipment will be explored.

A7-1.
Fixed Assets

Montana Operations Manual (MOM) section 2-1710.42 requires that, upon completion of any physical inventory, all necessary adjustments be made to the Property Accountability Management System (PAMS, the state's property records) to accurately reflect fixed asset totals. MOMs section 2-1710.42 also states, "In no event shall inventories be exclusively controlled by the custodian of the property records or the person to whom the fixed assets have been assigned." At June 30, 1989, the center had $1.3 million of fixed assets on its property records, including equipment purchased with federal Carl Perkins (CFDA #84.048) funds. The following two paragraphs discuss areas of concern related to the center's controls over equipment and compliance with state property policies.

In fiscal year 1987-88, the person responsible for recording the center's equipment on PAMS took the physical count of equipment. In fiscal year 1988-89, instructors responsible for custody of equipment took the physical count of equipment. Center personnel identified the differences between the physical inventory counts and property records, but did not determine the reasons for the differences or make any adjustments to PAMS based on the inventory counts.

As a result, center personnel estimated that equipment was overstated by $118,504 at June 30, 1989, because equipment no longer located at the center was not deleted from the center's property records. Because transactions input to PAMS update the center's accounting records, equipment in the Net Investment in Plant Fund is also overstated by $118,504 at June 30, 1989. The lack of segregation between custody of assets and inventory counts increases the possibility of undetected loss or theft of equipment. Without a timely identification of differences between PAMS and physical inventory counts, equipment not accounted for may not be detected nor action taken to determine reasons for differences soon enough to minimize losses.

Center personnel stated that the center does not have the financial resources available to establish adequate segregation of duties for inventory or to hire personnel to make adjustments for the equipment deletions. We believe the center could implement inexpensive controls to compensate for the lack of adequate segregation. Examples of the type of controls the center could establish would be to:

1. Have someone who does not have custody of the fixed assets perform and document random test counts.

2. Have center employees, other than those responsible for the equipment, perform the physical inventory count.

The center has already prepared a list of equipment that should be deleted, so the adjustments to the property and accounting records should not require substantial additional resources.

Recommendation A7-1

We recommend the center:

A. Establish adequate internal controls over fixed asset custody, count, and recordkeeping functions.

B. Resolve differences between physical inventory counts and PAMS, and make the necessary adjustments to PAMS, in a timely manner.

Response A7-1

The center concurs with these recommendations as follows:

A. Procedures for the fiscal year 1990 inventory are being designed to implement this recommendation.

B. Adjustments to PAMS will be made before fiscal year-end 1990.

A7-2.
Federal Compliance

The center participates in the following federal student financial aid programs: Pell Grants; Stafford Loans (formally Guaranteed Student Loans, or GSL); College Work Study (CWS); Supplemental Educational Opportunity Grants; and State Student Incentive Grants. In addition to the student aid programs, the center also received subgrants through CHE from the federal Vocational Education - Basic Grants to States, or Carl Perkins, program.

A7-2a.
Carl Perkins Subgrant

The center received $91,522 and $172,238 during fiscal years 1987-88 and 1988-89, respectively, in Carl Perkins (CFDA #84.048) federal assistance of which $68,717 and $106,105, respectively, was not separately accounted for or identifiable on the center's accounting records. Federal regulations require that the center's financial management system provide for:

1. Accurate, current, and complete disclosure of the financial results of each federally sponsored project.

2. Records that identify adequately the source and application of funds for federally sponsored activities.

Because the center did not separately identify financial activity for Carl Perkins projects on its accounting records, the required reports the center submitted to CHE are not supported by the center's accounting records.

In November 1988, a CHE official reviewed the center's use of Carl Perkins funds. In a letter to the center's director, the official discussed the following two areas of concern identified during the review:

1. Fiscal documentation deficiencies, including the need ". . . to <u>clearly</u> identify expenditures charged to project activities in the future . . ."

2. Ineffective communication within the center, due to personnel changes, concerning project management responsibilities.

The center's fiscal officer responded that the recommended corrective procedures would be implemented and created separate responsibility centers to account for Carl Perkins activity.

Correspondence from CHE to the center indicates the center had not requested reimbursement for fiscal year 1988-89 costs incurred on Carl Perkins projects as late as May 1989. Therefore, the center was violating the state law which requires the center to apply expenditures against non-General Fund money wherever possible before using state General Fund appropriations. In May 1989, two CHE officials reviewed the center's documentation of 1989 Carl Perkins project activities and determined whether documentation was acceptable and expenditures were allowable. As a result of unacceptable documentation and unallowable charges, the center lost $28,551 of anticipated Carl Perkins funding in fiscal year 1988-89.

The center should implement administrative and accounting controls to prevent similar occurrences in the future. The center should maintain accounting records that separately identify financial activity for each Carl Perkins project to facilitate preparation of reports, including requests for cash, and to provide adequate support for project activity.

Recommendation A7-2a

We recommend the center:

A. Establish effective administrative and accounting controls over Carl Perkins projects.

B. Clearly identify in its accounting records expenditures charged to each Carl Perkins project.

Response A7-2a

The center concurs with these recommendations as follows:

A. This has been implemented for fiscal year 1990 projects.

B. This has been implemented for fiscal year 1990 projects.

A7-2b.
Cash Management

We noted the center had excessive cash balances in the Pell Grant (CFDA #84.063) program. Federal regulations require the center to keep the minimum amount of cash possible. The center requests cash advances through an electronic transfer system from the U.S. Department of Education to finance its student financial aid disbursements. Federal guidelines indicate that institutions receiving funds through this system should keep no more cash than they plan to disburse within five working days. The center exceeded the guideline by 8 to 16 working days in each of four months tested. For example, an advance of $52,672 requested September 30, 1987, was not fully disbursed until October 19, 1987.

Financial aid personnel said they were not aware of the five day requirement, and thought it took at least that long for the funds to be available for use. Business office personnel indicated the funds were usually available for use the same day the advance was requested. We believe the center could meet the five day requirement through improved coordination between the business and financial aid offices.

Recommendation A7-2b

We recommend the center monitor federal student financial aid programs' cash balances and request cash in accordance with federal regulations.

Response A7-2b
The center concurs with this recommendation. This recommendation has been implemented.

A7-2c.
Federal Reporting

As part of managing federal student financial aid programs, the financial aid officer completes a federal report, by program, of the aid disbursed to students. He uses amounts recorded on manual records kept in the financial aid office, rather than the amounts recorded by the business office on the Statewide Budgeting and Accounting System (SBAS) to prepare the report. Federal regulations require recipients to establish and maintain financial records that reflect all program transactions in accordance with generally accepted accounting principles, and to ensure that financial reports contain reliable financial data.

The amount reported for CWS (CFDA #84.033) disbursements on the federal financial aid report was greater than the SBAS figure for fiscal years 1987-88 and 1988-89, by $304 and $2,090, respectively. The center did not accrue on SBAS $2,090 of June 1989 CWS expenditures, which caused the fiscal year 1988-89 difference. In fiscal year 1987-88, the amount reported on the federal financial aid reports for Pell Grant (CFDA #84.063) disbursements was $153 greater than the SBAS figure because center personnel abated expenditures on SBAS for the same $153 Pell Grant refund twice.

Center officials cited human error as the reason for the differences. In our prior audit report, we noted similar errors and recommended the center reconcile SBAS and the financial aid office's manual records before preparing federal financial reports. We believe such a reconciliation would have detected the errors. By correcting records for errors identified by such a reconciliation, the center would ensure that the financial aid reports contain reliable financial data and are supported by the center's primary accounting records.

Recommendation A7-2c

We recommend the center reconcile accounting and financial aid office records and correct errors noted before preparing federal financial aid reports.

Response A7-2c
The center concurs with this recommendation. This recommendation has been implemented.

A7-3. Accounting Issues

The center's financial information is used by center officials and legislators to manage and establish funding levels for the center. Section 17-1-102(4), MCA, states, "All state agencies, including units of the university system and the vocational-technical centers, shall input all necessary transactions to the accounting system . . . before the accounts are closed at the end of the fiscal year in order to present the receipt, use, and disposition of all money and property for which the agency is accountable in accordance with generally accepted accounting principles . . ." In addition, the Department of Administration, Accounting and Management Support Division, establishes state accounting policy as outlined in the Montana Operations Manual (MOM). The following report sections discuss instances where the amounts the center recorded on SBAS did not comply with state accounting policy and law.

A7-3a. Carl Perkins Subgrant in Unrestricted Subfund

The Commissioner of Higher Education (CHE) subgranted federal Carl Perkins (CFDA #84.048) funds to the center of $91,522 and $172,238 for fiscal years 1987-88 and 1988-89, respectively. The legislature appropriated, in the Current Unrestricted Subfund, $91,522 and $128,910 of Carl Perkins money to the center in fiscal years 1987-88 and 1988-89, respectively. In both fiscal years, the center recorded Carl Perkins activity to the extent of legislative appropriation in the Current Unrestricted Subfund. The center recorded Carl Perkins money

received in excess of the legislative appropriation in the Current Restricted Subfund.

Section 17-2-102, MCA, defines the uses of the Current Unrestricted and Restricted Subfunds as follows:

> "The unrestricted subfund segregates that portion of the current fund's financial resources that can be expended for general operations and is free of externally imposed restrictions, except those imposed by the legislature."
>
> "The restricted subfund segregates that portion of the current fund's financial resources that can be expended for general operations but only for purposes imposed by sources external to the board of regents and the legislature."

The state submits a plan to the U.S. Department of Education outlining proposed uses for Carl Perkins money granted to the state of Montana. The U.S. Department of Education must approve the plan before any Carl Perkins money is granted. Because the plan contains restrictions on the use of the money approved by a source external to the state, the center should record all Carl Perkins activity in the Current Restricted Subfund, except for that part attributable to indirect costs which is properly recorded in the Unrestricted Subfund. By recording Carl Perkins activity in the Current Unrestricted Subfund, the center's financial records are misstated as follows.

		Amount of Over (under) Statement	
Subfund	Account	FY 1987-88	FY 1988-89
Unrestricted	Transfers In	91,522	-0-
Unrestricted	Federal Revenues	-0-	128,910
Unrestricted	Federal Indirect Cost Recoveries	(5,497)	(6,236)
Unrestricted	Expenditures	86,025	122,674
Restricted	Federal Revenues	(86,025)	(122,674)
Restricted	Expenditures	(86,025)	(122,674)

The 1987 Legislature appropriated Carl Perkins federal assistance to the center in the Current Unrestricted Subfund. CHE officials indicated that conceptually the Carl Perkins activity should be in the Restricted Subfund, but because it was appropriated in the Unrestricted Subfund, they instructed the center to record the activity there up to the amount appropriated.

Recommendation A7-3a

We recommend the center account for Carl Perkins federal assistance in the Current Restricted Subfund in compliance with state law.

Response A7-3a
The issue of whether to record Carl Perkins moneys in the Unrestricted or Restricted Subfund is expected to be resolved by the Office of the Commissioner of Higher Education and the Legislature during the 1991 Legislative Session.

A7-3b.
Other Accounting Issues

During our review of the center's accounting records, we noted several other accounting transactions which were not in compliance with state accounting policy and law. Some of the errors we noted are listed below.

1. Payments totaling $21,481 for audit costs were coded to expenditure object #2998 - Goods Purchased for Resale-Higher Ed Recharges Operating, rather than expenditure object #2122-Contracted Services-Audit Fees.

2. Two separate payments for computer software, totaling $5,528, were coded to expenditure object #2928-Goods Purchased for Resale-Computer Software, instead of expenditure object #3401 or #3402-Intangible Assets-Multi-User or Single-User Software.

3. Center personnel did not calculate or record an entry to adjust the center's compensated absence liability at June 30, 1988. A calculation error caused the liability for compensated absences to be overstated by $6,644 at June 30, 1989.

In addition to the coding errors, we noted several documents, including four journal vouchers with eight $10,614 transactions transferring the $10,614 between various subfunds and programs, which did not have any support attached and were not

referenced to supporting documents. This may affect Carl Perkins (CFDA #84.048) federal assistance because of the issue discussed in section A7-2a.

Center personnel cited human error as the reason for many of these problems. We also noted that many of these transactions were coded and approved by the same person. We have made recommendations regarding accounting procedures in the three prior audit reports. In our prior audit, we recommended the center review document coding prior to input. Center personnel indicated they separated the transaction coding and approval function in fiscal year 1989-90, which we believe will help detect and prevent the types of problems noted above.

Recommendation A7-3b

We recommend the center separate the document coding and approval functions to ensure financial activity is recorded in compliance with state accounting law and policy.

Response A7-3b

The center concurs with this recommendation. This recommendation has been implemented.

A8-1.
Purchasing

Title 18, chapters 4 and 7, MCA, establish statutory parameters for purchasing supplies, equipment, certain services, and printing. Title 18, chapter 4, MCA, gives the state's Department of Administration authority to adopt rules consistent with law governing procurement of any and all supplies and services for the state. Federal regulations require the center to comply with state purchasing requirements for purchases made with federal funds.

The Department of Administration's Procurement and Printing Division operates a central stores program which procures, warehouses, and delivers certain common use items (such as office supplies, paper, and janitorial supplies) to state agencies. The Division also establishes term contracts with a predetermined price for high-use commodities. Term contracts are issued by competitive bid, and the successful vendor has the exclusive right to sell the product to the state for the established contract price.

State policy requires that, unless specifically addressed in a delegated purchasing authority agreement, state agencies must buy items controlled through central stores and term contracts. The center's delegated purchasing agreement requires it to use central stores and to obtain and document bids from a minimum of three vendors as follows: telephone quotations for purchases from $301 to $500 and written informal bids for purchases from $501 to $1,999.

The center frequently purchases supplies from local vendors, rather than through central stores. The center also does not follow purchasing requirements relating to the printing of its catalogs, letterhead, envelopes, student handbooks, and receipt books. For example, the center obtained verbal permission from the Procurement and Printing Division to have a local printer print its 1987-88 and 1988-89 catalogs, but did not seek permission to have its 1989-90 catalog printed locally. The center obtained and partially documented a telephone bid of $5,600 for

5,000 catalogs or $6,282 for 6,000 catalogs from the vendor that had printed the previous years' catalogs. The center had no documentation of other bids for printing its 1989-90 catalog.

The center also had a local printer print an accreditation report, costing $1,950, and the center's letterhead and envelopes, without going through the Procurement and Printing Division. The center obtained no bid for printing the accreditation report and center personnel did not sign a requisition for the report in accordance with center policy until after the report was printed. A Procurement and Printing Division official told us the state had a term contract with another supplier for envelopes, which was violated when the center obtained envelopes from the local printer.

The center also obtained grounds maintenance services costing $520 from a center employee's business without complying with the telephone bid documentation requirements. Center personnel indicated they obtain telephone bids for purchases, but only keep documentation of the low bid. The low bid documentation in this case was "low bid" written at the bottom of the statement requesting payment for the services.

By not complying with state purchasing requirements, the center may be paying more than necessary for supplies, printed materials, and services with state and federal Carl Perkins (CFDA #84.048) funds. Center personnel indicated they use central stores when possible, but sometimes center employees request specific items that cannot be purchased through central stores.

Recommendation A8-1

We recommend the center comply with state purchasing laws and regulations.

Response A8-1
The Center Director met with the Purchasing Agent on May 3, 1990 after the exit interview with the State Auditors to discuss the particulars of Recommendation A8-1. The outcome of the meeting resulted in the following action: Effective May 3, 1990, (1) all supplies will be purchased through the State's Central stores, and State term contracts will be honored, (2) all printing required by the Center will be in compliance with the State policy with the Procurement and Printing Division, (3) all maintenance contracts will be kept on file by the Maintenance Supervisor with proper statement of low bid amount or not interested in bidding so noted.

A8-2. College Work Study Contract

We reviewed all of the center's written contracts with College Work Study (CWS) employers for the audit period. During this review, we found a center employee, in his official capacity, entered into a contract during fiscal year 1988-89 with himself, as owner of a private for-profit business, to employ CWS (CFDA #84.033) students. A CWS employer who operates a for-profit business benefits by paying only 40 percent of the student's wages plus a 5 percent administrative fee. Federal CWS funds pay the other 60 percent of the student's wages.

One CWS student was employed under this contract during fiscal year 1988-89. Total wages paid the student were $405.88, of which $243.53 was paid from federal CWS funds. The employee stated he set up the contract to provide a student on-the-job training needed to obtain CWS employment with another for-profit business. The student later obtained CWS employment with the other for-profit business.

Section 2-2-201, MCA, prohibits public employees from being interested in any contract made by them in their official capacity. This transaction was a conflict of interest and may have been in direct violation of state law. In accordance with section 5-13-304, MCA, we referred this issue to the Attorney

General and the Governor's Office. When we informed the center director of this issue, he voided the contract as provided in section 2-2-203, MCA.

The center may contract with a private business owned by an employee so long as the employee is not the decision making or approving authority for the center and so long as other provisions of state law relating to the purchase of goods or services are followed. The center director had totally delegated CWS contracting authority to the center employee and did not review the center's CWS contracts. The center should develop procedures to ensure compliance with state law when entering into CWS contracts. For example, the director could periodically review the current CWS contracts, or require his approval of CWS contracts under specific (or all) circumstances.

Recommendation A8-2

We recommend the center implement procedures to comply with state law when entering into College Work Study contracts.

Response A8-2

The Center Director received the Interim Audit communication concerning Recommendation A8-2 on January 15, 1990, and immediately voided the in-questioned contract and implemented a procedure with the new Financial Aid Officer requiring both his and the Center Director's signature on all College Work-Study contracts. The Center Director respectfully notes that he did not delegate CWS contracting authority to the Center employee. It was the local school district in 1970 that authorized the authority.

A8-3. Employee Travel Advance and Reimbursement Procedures

During the audit period, center employees submitted signed travel expense vouchers, before traveling, documenting travel plans (such as departure and return times and destination) to the center director. The director completed the mileage, meals, and lodging allowances portion of the employees' signed travel expense vouchers. The director's secretary used the information provided by the employees and director to type new travel expense vouchers, which the director signed. The original travel expense vouchers containing the employees' signatures, which certify the vouchers are valid in accordance with state statutes and administrative procedures, were thrown away. Unless an employee had a major change in travel plans, the travel advances were not adjusted for actual allowable expenses documented on receipts for lodging and other expenses.

During audit work we noted a number of instances where this travel procedure resulted in noncompliance with state laws, including the following. This noncompliance with state travel reimbursement requirements could result in unallowable federal Carl Perkins (CFDA #84.048) expenditures.

1. Employees in travel status received meal allowances in excess of the amount allowed by section 2-18-502, MCA. Of seven travel expense vouchers tested, meal allowances of $211 approved by the center director exceeded allowances permitted under state law by $52, or twenty-five percent.

2. One employee received the maximum allowed for out-of-state lodging when actual costs were approximately twenty dollars less. Section 2-18-501, MCA, states "employees shall be authorized the actual cost of [out-of-state] lodging, not to exceed fifty dollars."

3. The same travel expense voucher was used to support advances to three employees who traveled to an out-of-state meeting. Although one person planned to attend the meeting for three days and the other two people each planned to attend the meeting one day, the travel advance was divided equally among the employees. As a result, one employee was advanced $98 less and the other two employees each $49 more than allowed. Center personnel said when they

realized the advance was miscalculated, the two employees with an excess gave the excess to the employee who was shorted.

Center personnel stated that the Butte School District policies for travel differed from state policy. They indicated the center, which is no longer under school district jurisdiction, is currently in the process of updating the center's travel policies to comply with state law. The center should develop adequate policies and procedures to ensure travel rates paid to employees are in accordance with state law.

Recommendation A8-3

We recommend the center develop and implement employee travel advance and reimbursement policies and procedures to ensure compliance with state employee travel laws.

Response A8-3

Recommendation has been complied with as of April 30, 1990 with calculation of travel by the Center's accountant.

A8-4. Property, Plant, and Equipment

The Property Accountability Management System (PAMS) is a centrally maintained subsystem of the Statewide Budgeting and Accounting System (SBAS) used to manage and account for the state's investment in fixed assets (property, plant, and equipment). Section 2-1700.00 of the MOM requires agencies that maintain a separate fixed asset system to submit summary totals to PAMS and SBAS at fiscal year-end. Section 2-1700.10 of the MOM states "Adequate accounting procedures and records are essential for the protection of state property." The State Plan for Vocational Education requires the center to account for property purchased with federal Carl Perkins (CFDA #84.048) funds in accordance with state regulations. The following equipment inventory system and unrecorded property issues, and the fixed asset control issue in section A8-5, discuss the center's noncompliance with these property requirements.

Equipment Inventory System

The center maintains a separate equipment inventory system and inputs summary totals only for equipment on PAMS and SBAS. The center has recorded fixed assets on PAMS and SBAS of $10,800,000, which includes $8,000,000 in buildings and $2,800,000 in equipment and other intangible assets. Land was not recorded on the center's records at June 30, 1989.

The center's equipment inventory system lists approximately $1,300,000 of equipment, so $1,500,000 of equipment recorded on PAMS and SBAS is not supported by the center's equipment inventory system. Center personnel indicated equipment in the small engines, auto mechanics, and portions of the civil engineering and machine shop areas of the center was not recorded on the center's equipment inventory system, but an estimate of the cost of these items is included in the equipment total on PAMS and SBAS. Center personnel indicated that when the center was built in 1985, the equipment to furnish the center cost approximately $2,300,000. While PAMS and SBAS amounts may be reasonable, center personnel have no accountability for equipment because they do not have a complete up-to-date listing of equipment supporting the accounting records.

Unrecorded Property

The center receives donated property, such as vehicles and engines, but does not record it on the equipment inventory system, PAMS, or SBAS. The center also has not recorded library books on PAMS, as disclosed in our prior audit report.

State policy requires agencies to record fixed assets acquired by gift at estimated fair market value on the date the gift is received. Center personnel estimated the value of donated assets exceeds $125,000. They contend the donated property is usually dismantled during training and of little value at that point. Agency personnel indicated that since the donated property is temporary in nature, it is not advantageous to record the property due to the amount of added paperwork. However, approximately $63,000 of this property consists of five vehicles,

three of which were donated in 1986 when they were new. Although donated property items are dismantled during training, we observed they are also put back together and appear to have a useful life greater than one year.

The person responsible for the library said she always takes a physical inventory count but was unaware a dollar amount should be recorded on PAMS. It was not cost beneficial to determine the value of the unrecorded library books because the center's library inventory records do not include historical costs for many items.

Recommendation A8-4

We recommend the center:

A. Perform a complete equipment inventory count and complete its equipment inventory listing.

B. Ensure the equipment amounts recorded on SBAS and PAMS are supported by the center's equipment inventory system.

C. Record all fixed assets on its property records, as required by state policy.

Response A8-4

The Center's equipment inventory clerk, who is the maintenance supervisor, after meeting with the State auditors concerning this issue, began on January 8, 1990 to conduct a complete inventory of the Center's equipment from scratch. As of April 30, 1990, the inventory clerk has inventoried approximately 33% of the building equipment. Estimated date of equipment inventory completion is December 1990. Recommendations A, B and C, will be completed by the end of December 1990.

A8-5.
Fixed Asset and Merchandise Inventory Controls

During our review of the center's system of internal controls related to inventory and fixed assets, we noted an inadequate segregation of duties within these functions. The instructors responsible for custody of the equipment also perform the physical inventory counts. The bookstore manager is responsible for ordering and monitoring merchandise inventory, daily cash receipt reconciliation and deposits, as well as physical counts.

Good internal control practices dictate that separate responsibility and control be assigned for the custody and recordkeeping functions related to inventory and fixed assets. Section 2-1710.42 of MOM states "In no event shall inventories be exclusively controlled by the custodian of the property records or the person to whom the fixed assets have been assigned." Section 2-1754.50 of MOM states that "Persons in charge of stockrooms and/or of maintaining perpetual inventory records should not be in charge of taking physical inventories."

Center personnel stated they were not aware of any problem relating to the segregation of duties over equipment and bookstore inventory. The lack of segregation between custody of assets and taking inventory increases the possibility of undetected loss or theft of equipment. We believe the center could implement inexpensive controls to compensate for the lack of adequate segregation. Examples of the type of controls the center could establish would be to:

1. Have employees who do not have custody of the fixed assets or merchandise inventory perform and document random test counts.

2. Have employees other than those responsible for the equipment or merchandise inventory perform the physical inventory count.

Recommendation A8-5

We recommend the center establish adequate controls over fixed asset and merchandise inventory custody, count, and recordkeeping functions.

Response A8-5
The Butte Vocational Technical Center concurs with Recommendation A8-5. The Center store inventory will be taken by an external source other than employees of the Center store. Implementation date is July 1, 1990.

Federal Compliance

To comply with federal audit requirements, our report discloses all federal compliance issues identified during the audit. These federal compliance issues are discussed on pages 17 through 23 of this report. During the audit period, the center participated in the following federal student financial aid programs: Pell Grants (CFDA #84.063); Stafford Loans (formerly Guaranteed Student Loans) (CFDA #84.032); College Work Study (CFDA #84.033); Supplemental Educational Opportunity Grants (CFDA #84.007); and State Student Incentive Grants (CFDA #84.069). In addition to the student aid programs, the center also received subgrants through Commissioner of Higher Education (CHE) from the federal Vocational Education - Basic Grants to States, or Carl Perkins (CFDA #84.048), program. All of the following federal issues, except for questioned CWS costs, could affect all of the center's federal student financial aid programs.

Financial Needs Analysis

A8-6. Background

Financial need is the difference between the student's cost of attendance and the student's ability to pay those costs. The center analyzes and determines each student's needs as follows:

Cost of Attendance	XXX
Less Expected Family Contribution	(XXX)
Less Pell Grant Award	(XXX)
Remaining Financial Need	XXX

The cost of attendance is an estimate of the student's expenses for the year, including tuition and fees, room and board, and other expenses such as transportation, books, supplies, and child care. The expected family contribution is computed by the U.S. Department of Education and reported on the Student Aid Report (SAR) for each student, based on the student's application for federal student aid. We noted the following problems regarding the center's financial needs analysis procedures.

A8-6a.
Family Contribution

During the audit period, the center included only 75 percent of the family contribution from the SAR in the needs analysis of each independent student, but included all of the family contribution for dependent students. Agency personnel indicated that the entire family contribution was not used because independent students must support themselves for the entire year and attend school for only nine months, or 75 percent of the year.

Beginning in fiscal year 1988-89, the U.S. Department of Education changed its method of computing the family contribution. Under the new method, the family contribution amount represents the student's ability to pay during the nine-month enrollment period. Therefore, the family contribution listed on the SAR should equal the family contribution used in the center's needs analysis.

The former financial aid officer contended he could adjust the family contribution for all independent students, as a group. The Department of Education does provide financial aid officers with the authority to adjust the family contribution when a student's status changes due to special circumstances. However, the adjustments must be made on an individual basis and must

be adequately documented in the student file. No documentation existed in the student files to indicate that special circumstances existed for the students in question.

By understating the family contribution, the center overstated each independent student's financial need. We requested center personnel to recalculate independent students' need analyses and determine the amount of overpayments made as a result of the misapplication of the family contribution. Center personnel determined 47 students received overawards totalling $8,842 in fiscal year 1988-89. Because federal regulations permit overawards up to $200 per student for non-Pell financial aid, center personnel determined the net overawards were $3,923 for fiscal year 1988-89. We question the allowability of $4,119 of non-Pell federal financial aid expenditures, which includes the related 5 percent of federal administrative cost allowance for fiscal year 1988-89. Center personnel indicated they started using 100 percent of the family contribution in all students' need analyses in January 1990.

<u>Recommendation A8-6a</u>

We recommend the center use the proper family contribution amount when calculating students' financial need for determining federal financial ald awards.

<u>Response A8-6a</u>
The Butte Vocational-Technical Center concurs with Recommendation A8-6a.

The Financial Aid Officer has implemented as of January 15, 1990 this requirement. The family contribution will be taken off the student aid report for the number of months enrolled.

A8-6b.
Child Care Allowance Policy

Federal regulations provide that, in fiscal year 1988-89, the cost of attendance may include a $1,000 child care allowance for students claiming dependents under the age of 12. The regulations require the center to determine if the student has a dependent child and if child care is necessary for the student to attend school.

In fiscal year 1988-89, the center's policy was to include a child care allowance in the cost of attendance for the students claiming children under the age of 12. The center did not always verify the existence of children claimed or determine if child care expenses were necessary for the student to attend school. The possibility exists that students claiming dependent children who received federal financial aid during fiscal year 1988-89 were overawarded financial aid based on the center's policies.

Recommendation A8-6b

We recommend the center establish a child care allowance policy that complies with federal regulations.

Response A8-6b
The Butte Vocational-Technical Center concurs with Recommendation A8-6b.

In order to comply with Recommendation A8-6b, the Financial Aid Officer has implemented a policy effective January 15, 1990 where no child care allowances are budgeted into the cost of attendance unless it is done on a case basis with proper documentation. The majority of independent students have a low family contribution under Congressional methodology so the majority of students automatically qualify for a substantial amount of Title IV funds to supplement their educational costs without including child care allowance in their budget.

A8-6c.
Cost of Attendance Calculation Errors

Of 31 students' costs of attendance reviewed, we found three problems, which center personnel indicated were the result of human error. In two instances, the $1,000 child care allowance was not included in the cost of attendance in accordance with center policy. In the other instance, the center could not explain how the cost of attendance was determined and they indicated that it was understated by $1,833. These errors caused the three students' need to be understated by a total of $3,833 and potentially resulted in underawards of federal financial aid to the students. The center could prevent such errors by revising the award notification form to list all potential components included in calculating cost of attendance (e.g., child care). This revision would also facilitate a more effective review of cost attendance calculations.

Recommendation A8-6c

We recommend the center revise the award notification form to facilitate accurate student financial aid cost of attendance calculations.

Response A8-6c

The Butte Vocational-Technical Center concurs with Recommendation A8-6c.

A policy was initiated on January 16, 1990 by the Financial Aid Officer to appropriate a straight forward cost of allowance for tuition and fees, room and board, books and supplies, and transportation and personal expenses included in the campus based budget. Tuition fees and living expenses are included in the Pell Budget. Budgets will be reviewed by the Financial Aid Officer before disbursement of Title IV funds. All award notifications have been revised in a format to assist the student in understanding their awards for the school year.

**A8-6d.
Cash Management**

The center requests cash advances through an electronic transfer system from the U.S. Department of Education to finance its student financial aid disbursements. Federal regulations require the center to keep the minimum amount of cash possible. Federal guidelines indicate that institutions receiving funds through an electronic transfer system should keep no more cash than they plan to disburse within five working days.

We noted the center maintained excess cash balances in student financial aid accounts during the current audit period. For the two months reviewed, cash remained at the center for up to two months after receipt. For example, it took the center approximately 48 days to fully disburse an $86,934 advance and approximately 30 days to fully disburse a $34,000 advance. To ensure proper federal cash management, the center should plan for and monitor financial aid disbursements for the purpose of estimating cash needs.

Cash management was also an issue addressed in our prior audit report of the center. In addition to the former financial aid officer's philosophical disagreement with federal cash management regulations and guidelines, center personnel indicated that funds were not disbursed within five days because:

1. The bank does not immediately notify the center when funds are received.

2. Recording the transactions on the state's accounting system, which must be done to generate the warrants disbursing the funds, took more than five days during the audit period.

3. The amount requested is an estimate and may vary due to changes in anticipated registration and withdrawals.

These three reasons do not justify the excessive delays in using cash advanced from the federal government. Now that the state's accounting system provides on-line entry and edit of accounting transactions, transactions may be processed more quickly than they were during the audit period. Center personnel should develop cash management procedures to ensure they

request and disburse federal student financial aid funds in accordance with federal regulations.

Recommendation A8-6d

We recommend the center request federal funds in accordance with federal regulations.

Response A8-6d
The Butte Vocational-Technical Center concurs with Recommendation A8-6d.

A policy has been initiated on January 16, 1990 to satisfy Recommendation A8-6d by the Financial Aid Officer. The Financial Aid Officer will only order as much cash as planned to disburse within a 5-day period. The Financial Aid Officer, the Center accountant, and the Financial Aid Accountant Specialist will oversee the transaction for control purposes of not having a balance in the account.

A8-6e.
Questioned College Work Study Costs

Federal regulations require an institution which allows its CWS (CFDA #84.033) students to be employed by a private for-profit organization to enter into a written agreement with that organization. The center could not produce contracts with four for-profit organizations that hired CWS students during fiscal years 1988-89 and 1989-90. The federal share of expenditures incurred under these contracts in fiscal year 1988-89 was $1,882.

Another contract with a for-profit organization stated it was effective December 21, 1989, but was signed by the financial aid officer who started work at the center on January 15, 1990. Federal moneys of at least $104 were expended under this contract prior to January 15, 1990.

Because of a turnover in the financial aid officer position, we were not able to determine why this situation occurred. The center should establish procedures to ensure federal funds are not used to pay CWS charges unless there is a valid CWS contract. We question CWS costs of at least $1,986 paid by the center without valid CWS contracts.

Recommendation A8-6e

We recommend the center establish procedures to ensure federal funds are not used to pay college work study charges without a valid contract.

Response A8-6e

The Butte Vocational-Technical Center concurs with Recommendation A8-6e.

Procedures were implemented by the Financial Aid Officer on January 17, 1990 requiring all private-for-profit organizations to have a valid work study contract on file with the Butte Vocational-Technical Center Financial Aid office before students will be employed. Non-profit organizations shall meet the same criteria.

A8-6f.
Student Aid File Retention

Federal regulations require recipients of federal student aid funds to retain student aid files for five years after filing their annual federal financial aid reports. We noted that the center retains student aid files for four years after submitting the annual federal reports.

Center personnel said they have always kept files for the current award year and the previous four award years. They were not aware of specific language in the federal regulation which required the five-year retention period to start after the annual

reports were filed for the year, rather than at the beginning of the year.

Recommendation A8-6f

We recommend the center retain student aid files in accordance with federal regulations.

Response A8-6f

The Butte Vocational-Technical Center concurs with Recommendation A8-6f.

Procedures have been implemented as of January 17, 1990 for the Financial Aid office to keep required files as noted in Recommendation A8-6f for a minimum of six (6) years.

A8-7. Accounting Issues

The center's financial information is used by center personnel, CHE officials, and legislators to manage and establish funding levels for the center. The following report sections discuss instances where the center's accounting records did not comply with section 17-1-102(4), MCA. This law requires state agencies to maintain their accounting records in accordance with generally accepted accounting principles (GAAP). In addition, the Department of Administration, Accounting and Management Support Division, establishes state accounting policy as outlined in the Montana Operations Manual (MOM). We also noted instances where the center's financial activity was not recorded in accordance with state accounting policy. The recommendation regarding these issues is located at the end of this section.

Carl Perkins Subgrant

The Office of the Commissioner of Higher Education (CHE) subgranted federal Carl Perkins (CFDA #84.048) funds of $121,613 and $157,903 to the center for fiscal years 1987-88 and 1988-89, respectively. The legislature appropriated, in the Current Unrestricted Subfund, $121,613 and $137,995 of Carl Perkins money to the center in fiscal years 1987-88 and 1988-89, respectively. In both fiscal years, the center recorded Carl Perkins moneys in the Current Unrestricted Subfund to the extent of the legislative appropriation. The center recorded any Carl Perkins money received in excess of the legislative appropriation in the Current Restricted Subfund.

Section 17-2-102, MCA, defines the uses of the Current Unrestricted and Restricted Subfunds as follows:

> "The unrestricted subfund segregates that portion of the current fund's financial resources that can be expended for general operations and is free of externally imposed restrictions, except those imposed by the legislature."
>
> "The restricted subfund segregates that portion of the current fund's financial resources that can be expended for general operations but only for purposes imposed by sources external to the board of regents and the legislature."

The state submits a plan to the U.S. Department of Education outlining proposed uses for Carl Perkins money granted to the state of Montana. The U.S. Department of Education must approve the plan before any Carl Perkins money is granted. Because the plan contains restrictions on the use of the money approved by a source external to the state, the center should record all Carl Perkins activity in the Current Restricted Subfund, except for that portion attributable to indirect costs which is properly recorded in the Unrestricted Subfund. By recording the Carl Perkins activity in the Current Unrestricted Subfund, the center's financial records are misstated as follows.

Subfund	Account	Amount of Over (under) Statement FY 1987-88	FY 1988-89
Unrestricted	Transfers In	$ 121,613	
Unrestricted	Federal Revenues		$ 137,995
Unrestricted	Indirect Cost Recoveries	(12,903)	(10,228)
Unrestricted	Expenditures	108,710	127,767
Restricted	Federal Revenues	(108,710)	(127,767)
Restricted	Expenditures	(108,710)	(127,767)

The 1987 Legislature appropriated Carl Perkins federal assistance to the center in the Current Unrestricted Subfund. CHE officials indicated that conceptually the Carl Perkins activity should be in the Restricted Subfund, but because it was appropriated in the Unrestricted Subfund they instructed the center to record the activity there up to the amount appropriated.

Pell Receivables

Federal regulations require institutions that disburse Pell grants (CFDA #84.063) to make a reasonable effort to collect receivables from students. At June 30, 1988 and 1989, the center had $39,402 and $41,600, respectively, of Pell receivables that were not recorded on the Statewide Budgeting and Accounting System (SBAS). Although some of these receivables had been outstanding for four years, the center had not referred them to the U.S. Department of Education, after making reasonable collection efforts, as required by federal regulations. The center's policy is to try collecting from students and return amounts collected to the U.S. Department of Education. The center should revise its Pell receivable collection policies and turn uncollected accounts over to the U.S. Department of Education after making reasonable collection efforts.

Center personnel indicated they were not aware that Pell refunds due should be recorded on SBAS. Pell refunds due are valid receivables of the center because the center has an obligation to recover them.

Other Accounting Issues

During our audit of the center's records, we noted several other accounting transactions which were not in compliance with state accounting policy. Some of the misstatements and misclassifications we noted are listed below.

1. The center recorded on its accounting records a compensated absences liability of $174,296 at June 30, 1988 and 1989. The center did not calculate or record an entry to increase its compensated absences liability as of June 30, 1989. As a result, the compensated absences liability is understated by approximately $58,500 at June 30, 1989.

2. The center made an error in adjusting the compensated absences liability at June 30, 1988. Center personnel attempted to correct the error in fiscal year 1988-89, but recorded the correcting entry twice. As a result, Amounts to be Provided for Compensated Absences is overstated at June 30, 1989, and Nonbudgeted Prior Year Expenditure Adjustments is understated for fiscal year 1988-89 by $41,853.

3. The center's bookstore inventory is recorded at selling price. Generally accepted accounting principles require inventory be recorded at the lower of historical cost or market value. As a result, Merchandise Inventory is overstated by approximately 25 percent, or $6,744 and $5,863 at June 30, 1988 and 1989, respectively, in the Auxiliary Subfund.

4. The center buys used books from students as part of its bookstore operations. However, the center does not properly account for the expenditures and revenue relating to the purchase and sale of used books. As a result of not properly recording used book activity, the center understated revenue and expenditures in the Auxiliary Subfund by approximately $1,400 during each fiscal year.

5. Generally accepted accounting principles require expenditures be recorded in the actual programs benefited. The center recorded the federal share of on-campus CWS (CFDA #84.033) expenditures of $22,449 and $23,126 in fiscal years 1987-88 and 1988-89, respectively, in the scholarships and fellowships program rather than the programs where the students worked.

6. The center classified all State Student Incentive Grant (CFDA #84.069) revenue as grants, contracts, donations and abandonments. However, $3,805 and $3,855 of this revenue in fiscal years 1987-88 and 1988-89, respectively, should have been classified as federal revenue.

Center personnel involved with the accounting functions cited several reasons for the misstatements and misclassifications, including human error. They also indicated they were not aware of accounting policies or recent changes in policies. In other cases, center personnel indicated they did not understand generally accepted accounting principles. By not recording all financial activity properly on SBAS, the quality of the resulting financial information is affected. As noted in the following report section, a number of the errors noted may have been avoided if the center's Montana Operations Manual was current and center personnel had access to state laws.

Recommendation A8-7

We recommend the center:

A. Record Carl Perkins subgrant activity, Pell receivables, and other financial activity in compliance with state law and policy.

B. Revise Pell receivable collection policies and turn accounts over to the U.S. Department of Education after making reasonable collection efforts.

Response A8-7

The Butte Vocational-Technical Center concurs with Recommendation A8-7.

A. The Commissioner of Higher Education Fiscal Affairs' personnel will address the Carl Perkins sub-grant with the 1991 Legislature as to restricted subfund-vs-unrestricted subfund.

B. The Financial Aid Officer implemented a policy and procedure on January 18, 1990 for collection of uncollected Pell grant accounts. When a student exits from the school, the Financial Aid Officer will review the student's Pell grant to identify the amount of money which must be refunded by the student. If a refund is required, a letter will be sent to the in-questioned student requesting payment in full or to meet with the Financial Aid officer to set up a payment schedule. The new policy will allow the student three (3) months, a reasonable amount of time, to contact the Center's Financial Aid office before the uncollected account is turned over to the U.S. Department of Education.

C. All other accounting issues were corrected as of February 1, 1990.

Federal Issues - Great Falls Vocational-Technical Center

A9-1.
Federal Compliance

To comply with federal audit requirements our report discloses all federal compliance issues identified during the audit. These federal compliance issues are discussed in sections A9-1a through A9-1c of this report. During the audit period, the center participated in the following federal student financial aid programs: Pell Grants; Stafford Loans (formerly Guaranteed Student Loans); College Work Study (CWS); Supplemental Educational Opportunity Grants (SEOG); and State Student Incentive Grants (SSIG). In addition to the student aid programs, the center also received subgrants through the Commissioner of Higher Education (CHE) from the federal Vocational Education - Basic Grants to States, or Carl Perkins, program.

A9-1a.
Financial Aid Overawards

Federal regulations make the center liable for any federal student financial aid overpayment it makes if the overpayment occurred because the center did not follow procedures prescribed in federal regulations. The center must restore funds used for such overpayments to the financial aid accounts, even if it cannot collect the overpayment from the student. During the prior audit, we noted Pell (CFDA #84.063) overpayments resulting from the center's noncompliance with federal regulations.

The center recalculated student financial aid awards and overpayments for fiscal years 1985-86 and 1986-87, as recommended in our prior audit. Center personnel determined 31 students received overpayments of financial aid. Because federal regulations permit overawards up to $200 per student in all programs except Pell grants, the following net overawards are the amounts which should be reimbursed to the financial aid accounts.

Type of Aid	Total Overawards	Net Overawards
Fiscal Year 1985-86:		
CWS (CFDA #84.033)	$2,469	$1,287
SEOG (CFDA #84.007)	2,426	671
SSIG (CFDA #84.069)	452	100
Pell (CFDA #84.063)	382	382
Total for Fiscal Year 1985-86	$5,729	$2,440
Fiscal Year 1986-87:		
Pell (CFDA #84.063)	2,038	2,038
Total	$7,767	$4,478

Center personnel did not reimburse the financial aid accounts for the overawards because they were not sure what procedures they should use to do so. Center personnel should work with Commissioner of Higher Education officials and the Department of Administration's Accounting and Management Support Division to reimburse the financial aid accounts for overawards.

Recommendation A9-1a

We recommend the center reimburse federal student financial aid accounts for overawards in accordance with federal regulations.

Response A9-1a

Partial concurrence. Receivables due from students shall be recorded on SBAS prior to year end, 1990. The U.S. Department of Education has been notified of these over-awards via the State of Montana. The center is awaiting further instructions. In an effort to expedite this issue, a letter has been forwarded directly from the center to the Department of Education requesting guidance in resolving the situation. The center does not wish to act until a written statement is received from the Department of Education. Upon notification, the center will comply in a timely fashion.

A9-1b.
Cash Management

Federal regulations require the center to keep the minimum amount of cash possible. The center requests cash advances, through an electronic transfer system, from the U.S. Department of Education to finance its student financial aid disbursements. Federal guidelines indicate that institutions receiving funds through this system should keep no more cash than they plan to disburse within five working days.

We noted the center maintained excess cash balances in student financial aid accounts during the current audit period. The center exceeded the requirement by 3, to over 30, working days in the three months tested. For example, it took the center approximately 14 working days to fully expend a $100,000 Pell (CFDA #84.063) advance and a $4,720 SEOG (CFDA #84.007) advance, and over 30 working days to fully expend a $1,200 CWS (CFDA #84.033) advance. The amount of federal cash requested is an estimate and may vary due to changes in anticipated registration and withdrawals. For proper federal cash management, the center should plan for and monitor financial aid disbursements for the purpose of estimating cash needs.

Excess federal cash was an issue addressed in our prior audit report of the center. Center personnel indicated that recording the transactions on the state's accounting system, which must be done to generate the warrants disbursing the funds, took more than five days during the current audit period. This accounts for some, but not all of the excess cash balances. Now that the state's accounting system requires on-line entry and edit of accounting transactions, transactions may be processed more quickly than possible during the audit period. Center personnel should develop procedures to better manage federal cash and to ensure disbursement of advanced federal funds within five working days.

Recommendation A9-1b

We recommend the center establish procedures to estimate cash needs and request federal funds in accordance with federal regulations.

Response A9-1b
Concur. Effective Fall Quarter 1989 the center addressed cash management with two major efforts:

1. By utilizing the On-Line Entry & Edit (OE&E) functions of SBAS, cash requests made by the fiscal office for federal moneys can be held in incomplete status and then released and expended when said funds are received thus reducing turn around time significantly.

2. By increasing the frequency of federal cash requests to coincide with the state payroll processing function, smaller amounts of cash are requested.

A9-1c.
Federal Program Review

In January 1990, a federal program specialist conducted a review of the center's federal student financial aid programs for the 1987-88, 1988-89, and 1989-90 award years. The issue resulting from the review which is still not resolved by the center is summarized below.

The center has a refund policy for tuition and fees, but does not have a refund and/or repayment policy for overpayments made to federal student financial aid recipients. Federal regulations require the center to develop, publish, and consistently apply a fair and equitable refund policy for students who withdraw, dropout, or are expelled.

Center personnel indicated they plan to implement a refund/repayment policy that complies with federal regulations by August 1, 1990, in conjunction with the center's change from the quarter to the semester system.

Recommendation A9-1c

We recommend the center implement a refund/repayment policy that complies with federal regulations.

Response A9-1c

Concur. The center is currently in the process of establishing a refund/repayment policy for overpayments made to federal student financial aid recipients. The policy will be completed and implemented by August 1, 1990, to correspond with the beginning of the Fall 1990 semester. This extension has been approved by the U.S. Department of Education.

A9-2. Equipment Controls

The center had recorded equipment of $1,159,253 on its fixed asset records at June 30, 1989. The center purchases equipment with federal Carl Perkins (CFDA #84.048) funds and state funds. The following paragraphs discuss our concerns with the center's controls over equipment.

In fiscal year 1987-88, instructors responsible for custody of equipment performed the physical count of equipment. In fiscal year 1988-89, the person responsible for recording the center's equipment on the property records performed the physical count of equipment for some departments and instructors took the physical count for other departments. Montana Operations Manual section 2-1710.42 states: "In no event shall inventories be exclusively controlled by the custodian of the property records or the person to whom the fixed assets have been assigned."

The lack of segregation between custody of assets, inventory counts, and recordkeeping increases the possibility of undetected loss or theft of equipment. Center personnel stated they were not aware that the center's equipment inventory count procedures resulted in an inadequate segregation of duties over equipment. Center personnel indicated they are comfortable with the current system because most equipment is used by more than one instructor each day, so loss of equipment would be detected.

We believe the center could efficiently implement controls to compensate for the lack of adequate segregation. Examples of the type of controls the center could establish would be to:

1. Have employees who do not have custody of the fixed assets perform and document sample test counts.

2. Have employees, other than those responsible for the equipment, perform the entire physical inventory count.

Recommendation A9-2

We recommend the center establish adequate internal controls over fixed assets.

Response A9-2

Concur. Effective fiscal year end 1990, the center will implement procedures that assure adequate internal controls over fixed assets.

A9-3.
Accounting Records

The center's financial information is used by center personnel, Commissioner of Higher Education officials, and legislators to manage and establish funding levels for the center. The following report sections discuss instances where the center's accounting records were not in compliance with section 17-1-102(4), MCA. This law requires state agencies to maintain their accounting records in accordance with generally accepted

accounting principles (GAAP). We also noted instances where the center's financial activity was not recorded in accordance with state accounting policy.

Carl Perkins Subgrant

The Office of the Commissioner of Higher Education (CHE) subgranted federal Carl Perkins (CFDA #84.048) funds of $145,312 and $165,286 to the center for fiscal years 1987-88 and 1988-89, respectively. The legislature appropriated, in the Unrestricted Subfund, $122,210 and $141,471 of Carl Perkins money to the center in fiscal years 1987-88 and 1988-89, respectively. In fiscal years 1987-88 and 1988-89, the center recorded Carl Perkins expenditures for projects budgeted in the Unrestricted Subfund of $121,702 and $136,936. The center recorded Carl Perkins money received for projects in excess of the legislative appropriation in the Restricted Subfund.

Section 17-2-103, MCA, defines the uses of the Unrestricted and Restricted Subfunds as follows:

> "The unrestricted subfund segregates that portion of the current fund's financial resources that can be expended for general operations and is free of externally imposed restrictions, except those imposed by the legislature."
>
> "The restricted subfund segregates that portion of the current fund's financial resources that can be expended for general operations but only for purposes imposed by sources external to the board of regents and the legislature."

The state submits a plan to the U.S. Department of Education outlining proposed uses for Carl Perkins money granted to the state of Montana. The U.S. Department of Education must approve the plan before any Carl Perkins money is granted. Because the plan contains restrictions on the use of the money approved by a source external to the state, the center should record all Carl Perkins activity in the Restricted Subfund, except for that portion attributable to indirect costs which is properly recorded in the Unrestricted Subfund. By recording

the Carl Perkins activity in the Unrestricted Subfund, the center's financial records are misstated as summarized below.

		Amount of Over(under) Statement	
Subfund	Account	FY 1987-88	FY 1988-89
Unrestricted	Transfers In	$ 121,702	
Unrestricted	Federal Revenues		$ 136,936
Unrestricted	Indirect Cost Recoveries	(9,163)	(10,643)
Unrestricted	Expenditures	112,539	126,293
Restricted	Federal Revenues	(112,539)	(126,293)
Restricted	Expenditures	(112,539)	(126,293)

The 1987 and 1989 Legislatures appropriated Carl Perkins federal assistance to the center in the Unrestricted Subfund. CHE officials indicated that conceptually the Carl Perkins activity should be in the Restricted Subfund, but because it was appropriated in the Unrestricted Subfund they instructed the center to record the activity there, up to the amount appropriated.

Pell Receivables

Federal regulations require institutions that disburse Pell grants (CFDA #84.063) to make a reasonable effort to collect receivables from students. At June 30, 1989, the center had $12,769 of Pell receivables that were not recorded on SBAS. Although some of these receivables had been outstanding for four years, the center had not referred them to the U.S. Department of Education after making reasonable collection efforts, as required by federal regulations. The center's policy is to try to collect money from students and to return amounts collected to the U.S. Department of Education. The center should revise its Pell receivable collection policies and turn uncollected accounts over to the U.S. Department of Education after making reasonable collection efforts.

Center personnel indicated they believe the Pell refunds due from students should not be recorded on the center's records because the center plans to turn the accounts over to the federal government. Pell refunds due are valid receivables of the center because the center has an obligation to recover them until either

the students repay the center or the center turns the accounts over to the U.S. Department of Education for collection.

Other Accounting Issues

Our audit disclosed other errors where the center did not apply accounting procedures in accordance with the state GAAP law or state policy. In addition, federal regulations require institutional recipients of Pell funds to establish and maintain financial records that reflect all program transactions in accordance with generally accepted accounting principles, and to ensure that financial reports contain reliable financial data. The following three items are examples of the types of problems we noted.

1. The center accounts for all financial activity relating to student government, which is funded by revenue from vending machines and student fees, in the Agency Fund. According to GAAP, an Agency Fund is used to account for the resources held by the center as a custodian or fiscal agent for individual students, faculty, staff members, and organizations. The Designated Subfund is used to account for resources that are internally designated by the governing board.

   Center management and the Board of Regents exercise significant control by establishing policies the student government must follow. Accordingly, student government activities do not meet the criteria of an Agency Fund and should be recorded in the Designated Subfund. The student government's revenues and expenditures for fiscal years 1987-88 and 1988-89 are approximately $14,000 and $18,000, respectively. The Designated Subfund's fund balance is understated by $7,812 at June 30, 1989.

2. The center classified all State Student Incentive Grant (CFDA #84.069) revenue as grants, contracts, donations, and abandonments. However, $4,819 and $5,026 of this revenue in fiscal years 1987-88 and 1988-89, respectively, was from federal sources and should be classified as federal revenue.

3. The center incorrectly increased, rather than decreased, deferred revenue in the Pell (CFDA #84.063) accounting entity at fiscal year-end 1988-89. As a result, deferred revenue was overstated and federal revenue was understated

by $1,352 in fiscal year 1988-89. Another error resulted in an understatement of $329 in Pell revenue. Center personnel reported revenue instead of expenditures on the Pell federal financial aid report. Therefore, the amount reported for Pell disbursements was $1,681 less than the SBAS figure for fiscal year 1988-89.

Center personnel involved with the accounting function cited several reasons for the above mistakes, including human error. Center personnel also indicated they were aware the student government financial activity needed to be moved to the Designated Subfund, but to date they have not moved the student government activity. The center's review of the federal financial aid report did not include a verification that the amounts reported agreed to SBAS. The center should develop a review process to ensure financial activity is recorded on the center's accounting records in accordance with state law and policy. The center should also ensure federal reports contain reliable financial data.

Recommendation A9-3

We recommend the center:

A. Record Carl Perkins subgrant activity, Pell receivables, and other financial activity in compliance with state law and policy.

B. Revise Pell receivable collection policies and turn accounts over to the U.S. Department of Education after making reasonable collection efforts.

C. Establish review procedures to ensure the center's accounting records comply with state law and policy, and federal student financial aid reports contain reliable financial data.

Response A9-3

A. Concur. This recommendation addresses several issues which have been given individual attention below.

The issue of whether to record Carl Perkins money in the unrestricted or restricted subfund is expected to be resolved by the Office of the Commissioner of Higher Education and the state legislature in the 1991 legislative session. The center will implement any changes in accounting as directed by the Commissioner's Office and/or the legislature to ensure common practice amongst all centers.

With regard to Pell receivables, the center will, beginning in June 1990, review Pell receivables on an annual basis prior to fiscal year end and record the appropriate entries onto SBAS to correctly reflect receivables at year end.

B. Concur. Policy is currently being written that addresses this recommendation. The policy will follow guidelines set forth by the U.S. Department of Education and will be implemented in June 1990 to coordinate with the review of Pell receivables mentioned in the center's reply to recommendation A9-3A.

C. Concur. Effective in September 1989 the center added another staff position to the business office. This additional FTE will allow internal control procedures and the review process to be strengthened.

Additionally, in September 1989 the center moved the student government activity account from the agency fund to the designated fund.

A10-1.
Accounting Records

Financial information of the center is used by center personnel, Commissioner of Higher Education officials, and legislators to manage and establish funding levels for the department. The center uses the Statewide Budgeting and Accounting System (SBAS) to record its financial activity. Section 17-1-102(4), MCA, requires state agencies to follow generally accepted accounting principles (GAAP) when recording information on its financial records. In addition, the Department of Administration, Accounting and Management Support Division, establishes state accounting policy as outlined in the Montana Operations Manual (MOMs). The following report sections discuss instances in which the center's accounting records do not comply with state accounting policy and law.

A10-1a.
Carl Perkins Subgrant

In fiscal years 1987-88 and 1988-89, the center received \$114,406 and \$217,953 in federal Carl Perkins (CFDA #84.048) moneys subgranted from the Commissioner of Higher Education (CHE). The center recorded all Carl Perkins activity in the Current Unrestricted Subfund.

Section 17-2-102, MCA, defines the uses of the Current Unrestricted and Restricted Subfunds as follows:

> "The unrestricted subfund segregates that portion of the current fund's financial resources that can be expended for general operations and is free of externally imposed restrictions, except those imposed by the legislature."
>
> "The restricted subfund segregates that portion of the current fund's financial resources that can be expended for general operations but only for purposes imposed by sources external to the Board of Regents and the legislature."

The state submits a plan to the U.S. Department of Education outlining proposed uses for Carl Perkins money granted to the state of Montana. The U.S. Department of Education must approve the plan before any Carl Perkins money is granted. The plan contains restrictions on the use of the money approved by a

source external to the legislature and the Board of Regents. Therefore, the money subgranted to the center should be recorded in the Current Restricted Subfund, except that portion attributable to indirect costs which is properly recorded in the Unrestricted Subfund. By recording the Carl Perkins activity in the Current Unrestricted Subfund, the center's financial records are misstated as summarized below.

Subfund	Account	Amount of Over (under) Statement FY 1987-88	FY 1988-89
Unrestricted	Transfers In	114,406	0
Unrestricted	Grants, Contracts, Donations, and Abandonments	0	217,953
Unrestricted	Federal Indirect Cost Recoveries	(7,111)	(15,394)
Unrestricted	Expenditures	107,295	202,559
Restricted	Federal Revenue	(107,295)	(202,559)
Restricted	Expenditures	(107,295)	(202,559)

The 1987 and 1989 Legislatures appropriated Carl Perkins federal assistance to the center in the Current Unrestricted Subfund. CHE officials indicated that conceptually the Carl Perkins activity should be in the Restricted Subfund, but because it was appropriated in the Unrestricted Subfund they instructed the center to record the activity there.

Recommendation A10-1a

We recommend the center account for Carl Perkins federal assistance in the Current Restricted Subfund in compliance with state law.

Response A10-1a

Concur. The 1987 and 1989 Legislatures appropriated Carl Perkins federal assistance to the center in the Current Unrestricted Subfund. This issue needs to be resolved by the Office of the Commissioner of Higher Education and the Legislature during the next legislative session.

A10-1b.
Other Accounting Issues

Our audit disclosed improper application of accounting procedures in three instances discussed below. In each instance, the center did not apply accounting procedures in accordance with state policy.

1. The center recorded federal Carl Perkins (CFDA #84.048) funds subgranted from CHE of $114,406 as a transfer in during fiscal year 1987-88 and of $217,953 as grants, contracts, donations and abandonments in fiscal year 1988-89. State policy requires these funds be classified as federal revenue. Because the centers had recorded this activity as transfers in under the Office of Public Instruction, CHE instructed all of the vocational-technical centers to continue to record Carl Perkins revenue in fiscal year 1987-88 as a transfer in but to record it as revenue beginning in fiscal year 1988-89.

2. The center entered into an intra-agency agreement with the Architecture & Engineering Division, Department of Administration, on June 30, 1989 to obtain approval for the paving of a parking lot estimated to cost $96,000. Also a contract was awarded for approximately $12,000 to have the apartment building located on the parking lot site demolished. The center transferred approximately $108,000 from the additional millage account received from the school district to the Plant Fund to pay for the projects.

   Although the projects were allowable valid obligations for fiscal year 1988-89 under state accounting policy, the center did not record a transaction to accrue the expenditures. Center personnel indicated they believed moving the funds from the Agency Fund where the millage funds were kept into the Plant Fund was actually expending the funds. State law requires that after July 1, 1989 any unexpended additional millage must be returned to the school district that requested the additional funding. Because the expenditure was a valid obligation the center is in compliance with the law, although since the expenditure was not recorded, the accounting records do not reflect compliance.

3. While recording transactions related to a prefabricated house built by the center, a transaction was input twice. As

a result fiscal year 1987-88 prior year expenditure adjustments are overstated and merchandise inventory is understated by $29,924 in the Designated Subfund.

Center personnel recorded an adjustment for a telephone bill twice on the accounting records. As a result prior year expenditure adjustments are understated and prior year revenue adjustments are overstated by $8,726 in the Unrestricted Subfund.

Center personnel cited human error as the reason for these duplicate transactions.

The center should establish procedures, such as a timely review of the monthly SBAS reports to ensure financial activity is recorded properly and to prevent recording duplicate transactions on the accounting records.

Recommendation A10-1b

We recommend the center establish procedures to ensure the center records financial activity in accordance with state accounting policy.

Response A10-1b

Concur. Federal Carl Perkins for FY 90 will be recorded as federal revenue. To ensure financial activity is recorded properly and to prevent duplicate transactions, we will more closely review all monthly SBAS reports.

A10-2. Equipment Controls

Instructors responsible for custody of equipment also perform the physical count of equipment, including equipment purchased with federal Carl Perkins (CFDA #84.048) funds. State policy provides that inventories not be exclusively controlled by the person to whom the fixed assets have been assigned. The lack

of segregation between custody of assets and physical counts increases the possibility of undetected loss or theft of equipment.

Although a spot check of the inventory count was performed by someone other than the instructors, these spot checks were not documented. Center personnel indicated they didn't realize the test counts would have to be documented to prove they were done.

Recommendation A10-2

We recommend the center develop and implement adequate controls over the equipment count function.

Response A10-2

Concur. In order to ensure adequate control over the equipment inventory system, the Property Control Officer of the Helena Vo-Tech Center will conduct a random sampling of all equipment inventories. Upon its completion, this will be documented and maintained on file.

Federal Assistance

The center participates in the following federal student financial aid programs: Pell Grants, College Work Study (CWS), Supplemental Educational Opportunity Grants (SEOG), State Student Incentive Grant (SSIG), and Stafford Loans (formerly Guaranteed Student Loans). Most of the center's federal assistance, other than the student aid programs, is from Vocational Education Basic Grants to states (Carl Perkins) subgranted from the Commissioner of Higher Education.

The following report sections discuss instances in which the center is not in compliance with federal regulations and guidelines.

A10-3. Pell Grant Disbursement

Federal regulations allow an institution to pay a Pell Grant (CFDA #84.063) by issuing a check for the entire award amount; or by crediting the student's tuition and fees account and issuing a check to the student for the difference. The center begins class registration with state warrants prepared for issuance to recipient students in the amount of the student's entire Pell Grant award. Students may either accept the state warrant for the amount of their total Pell Grant award and pay their tuition and fees with their own funds or have their tuition and fees deducted from the Pell Grant. These procedures have caused the center to cancel a high number of warrants and have difficulties with federal cash management.

When a student chooses to have tuition and fees withheld from the Pell Grant, the center cancels the original state warrant, since the amounts are for the total Pell Grant award, and issues another warrant for the difference between the award amount and the student's tuition and fees. We estimated the center cancelled 194 warrants totalling $100,340 in fiscal year 1987-88 and 192 warrants totalling $122,993 in fiscal year 1988-89. Approximately one-fourth of the original warrants issued for Pell Grants were cancelled in both fiscal year 1987-88 and 1988-89. Issuing, cancelling, and reissuing warrants requires additional time and effort and creates the risk that a state warrant will accidentally be distributed to students when it should be cancelled.

The center requests cash advances through an electronic transfer system from the U.S. Department of Education to finance student financial aid disbursements. Department of Education guidelines indicate that institutions receiving funds through this system request no more cash than they plan to disburse within five days of receipt. During the audit we noted that the center had excessive cash in both months tested. In November 1988 the center requested an $150,000 advance (for all of the financial aid programs) that was not fully disbursed by February

1989. A $200,000 advance received in August 1987 was not fully disbursed by November 1987. The majority of the advances are for Pell Grant disbursement.

Center personnel were unaware that the U.S. Department of Education had established a five day guideline for disbursement of funds. In addition, they believe its current Pell disbursement procedures prevent compliance with the federal guidelines. Pell disbursements take up to six weeks to complete due to the number of warrants that the center must cancel and reissue.

In our prior audit of the center we recommended the center modify and improve its Pell Grant disbursement system. Center personnel indicated that no satisfactory alternative procedure could be found. We believe the center could significantly decrease the number of Pell Grant warrants cancelled and comply with federal guidelines related to cash management by changing its disbursement procedures and by monitoring cash balances. For example, the center could credit all Pell Grant recipients' accounts for tuition and fees and prepare warrants for the difference between award amounts and tuition and fees. By waiting until after the students have registered before preparing the state warrants the center could also avoid over-awards for students whose status changes.

Recommendation A10-3

We recommend the center:

A. Implement Pell Grant disbursement procedures to reduce the number of cancelled warrants.

B. Monitor federal student financial aid programs' cash and request cash in accordance with federal guidelines.

Response A10-3

Concur.

A. The Pell Grant disbursement procedure is changed for the 1990-91 academic year. We will automatically credit the students' tuition and fees account and issue a check for any remaining balance on their Pell Grant.

B. Federal cash requests will be made monthly, and only as needed. Only a minimum cash balance will be maintained to adequately provide for the College Work Study payroll which occurs every two weeks.

A10-4.
Financial Needs Analysis Background

Financial need is the difference between the student's cost of attendance and the student's ability to pay those costs. The center analyzes and determines each student's need as follows.

Cost of Attendance	XXX
Less Expected Family Contribution	(XXX)
Financial Need	XXX

The cost of attendance is an estimate of the student's educational expenses for the year. The cost of attendance includes such categories as tuition and fees, room and board, transportation, and books. The financial aid officer determines the cost of attendance for SSIG, SEOG, Stafford Loans, and CWS financial aid programs through a biennial survey of students. The responses are averaged and combined to determine a total. For alternate years, the center adjusts the previous year's cost of attendance using national cost of living statistics. Under federal regulations, cost of attendance is computed differently for Pell Grants than for other student financial aid because the U.S. Department of Education limits the types of costs allowed.

The expected family contribution used in the Pell Grant program is known as the Student Aid Index (SAI) and for the other federal student aid programs is the Family Contribution (FC). The FC and SAI are computed by the U.S. Department of

Education and are reported on the Student Aid Report (SAR) for each student, based on the student's application for federal aid.

Based on the student's Pell cost of attendance and SAI number, the center determines each student's Pell Grant award from payment schedules provided by the U.S. Department of Education. The center attempts to award other types of student financial aid up to the student's remaining financial need.

A10-4a.
Cost of Attendance

The cost of attendance used for SSIG (CFDA #84.069), SEOG (CFDA #84.007), Stafford Loans (CFDA #84.032), and CWS (CFDA #84.033) in fiscal year 1987-88 does not equal the sum of the individual allowances determined in the survey. As a result, the cost of attendance is overstated by $36 to $81 per year per student. Because the center is not able to award the full amount of students financial need we did not find any examples of students receiving an overaward. However, the potential for overawards exists due to the cost of attendance overstatement.

Federal regulations require that the institutions' cost of attendance for a student consist of the sum of the allowances and allowable charges applicable to the student. Center personnel believe the differences are due to the rounding of numbers by the computer program.

Recommendation A10-4a

We recommend the center calculate cost of attendance in compliance with federal regulations.

Response A10-4a

Concur. Effective for the 1990-91 academic year, we will check totals for cost of attendance to ensure the accuracy of the student budgets.

A10-4b.
Student Financial Need

The center uses the computer to document its calculation of student financial aid awards for SSIG (CFDA #84.069), SEOG (CFDA #84.007), Stafford Loans (CFDA #84.032) and CWS (CFDA #84.033). The student files do not contain the actual components used to calculate student financial aid. We noted the cost of attendance on the computer for four out of 32 student financial aid files tested did not agree to the fiscal year 1988-89 cost of attendance. In addition, for the same four students the amounts used for the family contribution did not match the amounts listed on the Student Aid Reports.

Center personnel researched the errors and found the cost of attendance and family contributions currently on the computer corresponded to fiscal year 1989-90 information for those students. It appears the fiscal year 1989-90 information replaced the older files on the computer.

Federal regulations require an institution to apply the cost of attendance in a uniform manner among the students depending upon their status, and, unless changes have occurred in family income or resources, the institution is required to use the family contribution on the Student Aid Report. When computer documentation of the components does not agree to the actual cost of attendance and family contribution, documentation is not adequately maintained. The center should generate a hard copy report of the financial aid components before new information is input on the computer.

Our prior audit also included a recommendation to the center to calculate students' financial need in accordance with federal regulations.

Recommendation A10-4b

We recommend the center adequately document the components used in calculating student financial aid awards.

Response A10-4b

Concur. Effective for the 1989-90 academic year, student files contain the actual components used to calculate student financial need. The computer system is changed for the 1990-91 award year so students' financial information cannot be written into the wrong academic year.

A10-4c.
Pell Grant Awards

During testing of student financial aid files we noted that the Pell Grant (CFDA #84.063) awards were incorrect for two students out of 32 student files tested.

- One student was given an improper status that caused an overaward of $300. Center personnel stated that this was due to an input error.

- The center used the wrong amount from the Pell Grant matrix to award student aid to the second student. This resulted in an underaward of $50. Center personnel believe that this error was due to an input error made when the matrix was entered into the computer.

A review of data entered into the computer could detect the type of errors noted above.

Recommendation A10-4c

We recommend the center ensure the proper amounts are awarded for Pell Grants.

Response A10-4c

Concur. All data entered into the computer will be reviewed for the 1990-91 academic year. Furthermore, the financial aid analysis system for the 1990-91 academic year will dramatically cut the amount of data entry and reduce chances for input error.

A10-4d. Summary

The center determined that the present computer system used for federal student financial aid programs (funded by U.S. Department of Education) no longer meets the center's needs and has switched to manual records during fiscal year 1989-90. A financial aid software package has been ordered that they estimate will be implemented in fiscal year 1990-91. We believe that the type of errors noted could have been detected through an adequate review procedure. Regardless of the system used, the center should establish procedures to ensure the accuracy of data used in the calculation of student financial aid needs.

Recommendation A10-4d

We recommend the center establish review procedures to ensure:

A. The accuracy of all information used in calculating student financial aid awards.

B. The center is in compliance with federal regulations related to student financial aid.

Response A10-4d

Concur. All information used in calculating financial aid will be reviewed before award letters are run for the 1990-91 academic year. A complete manual student file review process was implemented in November, 1989. The financial aid officer is and will continue to receive training to keep current on federal regulations.

A10-5.
Computer Access

Financial aid awards used for federal student financial aid programs (funded by U.S. Department of Education) are computed after student information such as cost of attendance, student aid index and family contribution are entered into the computer. During testing we noted that several individuals perform the data entry function, including College Work Study students. Once center personnel access the computer the student is allowed access to individual program functions, including the edit function. The potential increases for unauthorized changes to occur when a financial aid recipient is allowed access to financial aid information. In addition, the potential for errors increases when individuals unfamiliar with the financial aid process are allowed to enter and edit data.

Although some of the input was reviewed, this review was not documented or sufficient to detect the type of errors that could occur because the access weakness exists. Center personnel said that College Work Study students entered information because it required relatively little supervision and they did not realize the weakness in access controls it created. The center should limit access to financial aid files and information.

Recommendation A10-5

We recommend the center establish adequate access controls over financial aid information and programs.

Response A10-5

Concur. Work study students have not been used to enter financial aid information since November, 1989. For the 1990-91 award year only two staff will have training on how to access information on the new financial aid software.

A10-6.
Pell Reconciliation

Federal regulations require the center to establish and maintain, on a current basis, financial records that reflect all program transactions. Regulations also require institutions' net expenditures to Pell Grant (CFDA #84.063) recipients should equal the total shown on the final page of the student payment summary. If the institution's net expenditures do not agree with the student payment summary then the institution must correct each student record which has a discrepancy.

The center submits information to the U.S. Department of Education at the beginning of each award year listing the estimated Pell Grant award amounts by student. The center did not send updates during the year when actual disbursements differed from the estimated amounts. As a result, the final student payment summary compiled by U.S. Department of Education based on the information sent by the center during the year does not tie to either the amount on a report submitted to the federal government for Pell disbursements or to SBAS, the center's primary accounting records. The center did not reconcile the final student payment summary, as required by federal regulation, or the financial aid files to SBAS before submitting the federal report.

The Pell disbursements reported on the federal report tie to SBAS, but because no reconciliation was performed, the center has no assurance that the amounts reported are correct or are supported by the financial aid records. The center was able to reconcile the difference between SBAS and the payment list for fiscal year 1987-88, but noted a difference of $1,891 for fiscal year 1988-89.

We believe the center could send updates when the disbursement amounts change from the original estimate. This would facilitate reconciling any differences between the final payment summary and SBAS when preparing the federal reports to ensure the center is submitting accurate information as required by federal regulations.

Recommendation A10-6

We recommend the center establish procedures to reconcile the final Pell student payment summary to SBAS before submitting federal reports.

Response A10-6

Concur. We are establishing procedures to reconcile the final Pell student payment summary to SBAS before submitting federal reports for the 1989-90 academic year. We have already submitted updates to correct inaccuracies found in the current year.

A10-7.
Stafford Loans

The center completes the institution portion of Stafford Loan (CFDA #84.032) applications listing cost of attendance, family contribution, and expected financial assistance for the period enrolled. Occasionally, a student will not enroll for an entire school year. In these circumstances the center allocates the student's cost of attendance and family contribution to reflect mid-year enrollment. We noted that for two of the 26 Stafford Loan student files tested the center did not properly allocate the family contribution to reflect attendance for less than the full school year. Student need was understated on the loan applications by $484. Center personnel indicated this was the result of human error.

Recommendation A10-7

We recommend the center follow established procedures of allocating cost of attendance and family contribution for mid-year enrollment for Stafford Loans.

Response A10-7

Concur. We have established procedures for allocating cost of attendance and family contribution for mid-year enrollment for Stafford Loans. This will include a review process as well.

A10-8.
Carl Perkins

The center receives Carl Perkins (CFDA #84.048) federal assistance subgranted from the Commissioner of Higher Education. Recipients of the funds are required to provide a 50 percent state and local match for all federal funds expended.

The center maintains separate responsibility centers on SBAS for each Carl Perkins project that includes all of the federal expenditures and some of the required match expenditures. However, the federal expenditures are not distinguishable from the match expenditures nor are they a consistent percentage of the total expenditures. Federal regulations require that a recipient's financial management system, SBAS in the case of the center, provide for: (1) accurate, current and complete disclosure of the financial results of each federally sponsored project and (2) records that identify adequately the source and application of funds for federally sponsored activities.

Because the center did not adequately identify Carl Perkins on SBAS, the center is not in compliance with the federal regulation and the required reports submitted to the Commissioner of Higher Education (CHE) are not supported by SBAS. For fiscal year 1987-88 the center reported $118,687 in federal Carl Perkins expenditures on the report to CHE when actual expenditures were $114,406.

Recommendation A10-8

We recommend the center:

A. Separately identify Carl Perkins federal revenues and expenditures on SBAS.

B. Adequately document state and local match expenditures for Carl Perkins funds.

Response A10-8

Concur.

A. Carl Perkins federal revenues are currently being identified separately on SBAS. Expenditures for only the federal portion of each Carl Perkins project will be recorded separately in specific SBAS responsibility centers.

B. As noted in our response to A10-8A, all expenditures for Carl Perkins funds will be separately recorded in SBAS by the individual projects.

Federal Issues - Missoula Vocational-Technical Center

A11-1. Equipment Controls

The center reported equipment of $2,015,436 on its fixed asset records at June 30, 1989. The following paragraphs discuss areas of concern related to the center's controls over equipment.

The person responsible for custody of equipment also takes the inventory of equipment. Montana Operations Manual section 2-1710.42 states: "In no event shall inventories be exclusively controlled by the custodian of the property records or the person to whom the fixed assets have been assigned." The lack of segregation between custody of assets and inventory counts increases the possibility of undetected loss or theft of equipment. Center personnel indicated they are comfortable with the current system because most equipment is used by more than one instructor and, if equipment were missing, the instructors would notice and report the loss. Center personnel also indicated they occasionally verify a sample of inventory counts.

We believe the center could improve controls over equipment by having center staff inventory equipment other than that for which they are responsible; or by having someone who does not have custody of the equipment perform and document sample counts. We believe the cost to implement either of these options would not be significant to the center.

State policy requires that agencies assign a property number and tag to each fixed asset and that the inventory tags be promptly affixed to the asset. We noted one instance where the center purchased 15 computers and printers costing $24,750 in October 1988, but did not record the equipment on the property records or assign property numbers until April 1989. One quarter of the cost, or $6,187, of this equipment was paid from Carl Perkins funds (CFDA #84.048). Center personnel indicated they try to assign property numbers and record equipment on the property records within one month of receipt. They were not sure what caused the delay in this case. Having unrecorded, untagged equipment increases the possibility of undetected loss or theft of those assets.

Recommendation A11-1

We recommend the center develop and implement procedures to:

A. Segregate equipment custody, count, and record keeping functions.

B. Ensure equipment is promptly tagged and recorded on its property records.

Response A11-1

Concur. Inventory at the Center is generally accomplished by having two or more team members take the physical inventory. Purchases of equipment are normally recorded within 30 days of purchase. The instance cited was an oversight on the part of Center staff.

Plan for Corrective Action

Inventory will continue to be taken by multi-member teams. Center personnel not associated with a particular department will randomly sample departmental inventories to verify counts. Center personnel will strive to record and tag all equipment purchases within 30 days of acquisition.

A11-2. Accounting Issues

Section 17-1-102(4), MCA, requires state agencies to follow generally accepted accounting principles (GAAP). We noted instances where the center did not follow GAAP, including the following four accounting issues. The recommendations regarding these issues are located at the end of this section.

Carl Perkins Subgrant

The Office of the Commissioner of Higher Education (CHE) subgranted federal Carl Perkins (CFDA #84.048) funds of $442,839 and $145,194 to the center for fiscal years 1987-88 and 1988-89, respectively. The legislature appropriated, in the Current Unrestricted Subfund, $326,987 and $145,196 of Carl Perkins money to the center in fiscal years 1987-88 and 1988-89, respectively. In both fiscal years, the center recorded Carl Perkins moneys in the Current Unrestricted Subfund to the extent of the legislative appropriation. The center recorded any Carl Perkins money received in excess of the legislative appropriation in the Current Restricted Subfund.

Section 17-2-102, MCA, define the uses of the Current Unrestricted and Restricted Subfunds as follows:

> "The unrestricted subfund segregates that portion of the current fund's financial resources that can be expended for general operations and is free of externally imposed restrictions, except those imposed by the legislature."
>
> "The restricted subfund segregates that portion of the current fund's financial resources that can be expended for general operations but only for purposes imposed by sources external to the board of regents and the legislature."

The state submits a plan to the U.S. Department of Education outlining proposed uses for Carl Perkins money granted to the state of Montana. The U.S. Department of Education must approve the plan before any Carl Perkins money is granted. Because the plan contains restrictions on the use of the money approved by a source external to the state, the center should record all Carl Perkins activity in the Current Restricted Subfund, except for that portion attributable to indirect costs which is properly recorded in the Unrestricted Subfund. By recording the Carl Perkins activity in the Current Unrestricted Subfund, the center's financial records are misstated as summarized below.

		Amount of Over (under) Statement	
Subfund	Account	FY 1987-88	FY 1988-89
Unrestricted	Transfers In	$ 326,987	$ 0
Unrestricted	Federal Revenues	0	145,194
Unrestricted	Indirect Cost Recoveries	(22,421)	(8,845)
Unrestricted	Expenditures	304,566	136,349
Restricted	Federal Revenues	(304,566)	(136,349)
Restricted	Expenditures	(305,566)	(136,349)

The 1987 Legislature appropriated Carl Perkins federal assistance to the center in the Current Unrestricted Subfund. CHE officials indicated that conceptually the Carl Perkins activity should be in the Restricted Subfund, but because it was appropriated in the Unrestricted Subfund they instructed the center to record the activity there up to the amount appropriated.

Pell Receivables

Federal regulations require institutions that disburse Pell grants (CFDA #84.063) to make a reasonable effort to collect receivables from students. At January 31, 1990, the center had $20,786 of Pell receivables that were not recorded on the Statewide Budgeting and Accounting System (SBAS). Although some of these receivables had been outstanding for six years, the center had not referred them to the U.S. Department of Education, after making reasonable collection efforts, as required by federal regulations. The center's policy is to try to collect money from students and to return amounts collected to the U.S. Department of Education. The center should revise its Pell receivable collection policies and turn uncollected accounts over to the U.S. Department of Education after making reasonable collection efforts.

Center personnel indicated they believe the Pell refunds due from students are not a valid receivable of the center or the state because the center is not responsible for returning the money to the federal government until the money is collected. Pell refunds due are valid receivables of the center because the center has an obligation to recover them until the students repay the center or until the center turns the students' accounts over to the U.S. Department of Education for collection.

Interdepartmental Eliminations

During fiscal year 1988-89, the center established recharge operations for duplicating services and central stores. A recharge operation allows a central department to provide goods or services to other departments on a cost reimbursable basis. For example, central stores personnel purchase supplies from vendors which the various departments at the center then obtain from central stores.

Each recharge operation records all purchases the departments make each month and bills them at month end. The recharge center records revenue collected from the various departments billed, while the individual departments record expenditures for the amount paid to the recharge center. The recharge center also records expenditures for its operating costs.

At year-end, the center should, but did not, eliminate the revenues and expenditures recorded in the recharge centers. This resulted in the revenues and expenditures being recorded on the accounting system twice. By not making the necessary entry, revenues and expenditures are overstated by $32,702 in the Designated Subfund. Center personnel indicated they were aware of eliminating interdepartmental charges, but forgot to make the entry.

College Work Study (CWS) Expenditures

The center recorded the federal share of CWS (CFDA #84.033) expenditures of $33,309 and $30,263 in fiscal years 1987-88 and 1988-89, respectively, in the scholarships and fellowships program rather than the actual programs where the students worked (benefited programs) as required by GAAP. Center personnel indicated the CWS expenditures were recorded in the scholarships and fellowships program based on direction from CHE.

CHE personnel indicated they told the centers to record CWS in the scholarships and fellowships program so they would not have to establish CWS budgets in each of the benefited programs. However, CHE indicated the centers were to distribute the

expenditures to the benefitted programs at fiscal year-end. CHE personnel indicated their instructions to the center were verbal and not confirmed in writing. CHE should provide the center with written procedures or confirm policy decisions in writing.

Recommendation A11-2

We recommend:

A. The center record Carl Perkins subgrant activity, Pell receivables, interdepartmental eliminations, and College Work Study expenditures in compliance with state law and policy.

B. The center revise Pell receivable collection policies and turn accounts over to the U.S. Department of Education after making reasonable collection efforts.

C. The Commissioner of Higher Education provide the center with written confirmation of accounting policy decisions.

Response A11-2A and B

We partially concur with A and fully concur with B.

Carl Perkins Subgrant

The issue of where to record appropriated federal Carl Perkins monies is unclear. The legislature appropriated the funds in question to the Center's Current Unrestricted Subfund for use in the general operation of the Center. The Center followed legislature intent by depositing the funds in the Current Unrestricted Subfund and expending them for general operation of the Center. The Carl Perkins funds do, however, have restrictions imposed upon them by an external source. Because of this restriction a case could be made to require deposit of the monies in the Restricted Subfund.

Pell Receivables
Center personnel concur that Pell refunds due from students should be turned over the U.S. Department of Education for collection.

Interdepartmental Eliminations
Center personnel concur that revenues and expenditures should be eliminated at year-end.

College Work Study Expenditures
Center personnel concur that College Work Study expenditures should be recorded in the program in which the students actually worked.

Plan for Corrective Action
The issue of whether to record Carl Perkins monies in the Unrestricted or Restricted Subfund is expected to be resolved by the Office of the Commissioner of Higher Education and the legislature during the next legislative session.

Pell receivables for previous years have been processed and turned over to the U.S. Department of Education for collection. Procedures will be developed to process future receivables and ascertain they are turned over to the U.S. Department of Education in a timely manner.

Interdepartmental eliminations will be made at the end of each fiscal year.

College Work Study expenditures will be distributed to the benefitted programs at fiscal year-end.

Response A11-2C:
Concur. In February 1990 specific written policy on accounting for College Work Study was reviewed with the Vocational-Technical Center Fiscal Officers.

It is the intent of the Commissioner's Office to provide written confirmation of all accounting policy decisions to the

Vocational-Technical Centers. However, with limited staff, that is not always possible. The office is not adequately staffed to monitor all transactions and cite relevant policy in each situation. Every effort will be made to comply with this recommendation with the resources available.

B1-1.
Accounting Records

Financial information of the Judicial Branch is used by court administrative officials, legislators, and others to manage and establish funding levels for the Judicial Branch. The Judicial Branch uses the Statewide Budgeting and Accounting System (SBAS) to record its financial activity. Section 17-1-102(4), MCA, indicates "all state agencies . . . shall input all necessary transactions to the accounting system . . . in order to present the receipt, use, and disposition of all money and property for which the agency is accountable in accordance with generally accepted accounting principles . . ."

We noted the following instances where amounts recorded on SBAS did not comply with this law:

1. In fiscal year 1987-88, the Judicial Branch improperly charged a portion of federal subgrant expenditures from the Criminal Justice Block Grant (CFDA #16.573) to the General Fund instead of the Special Revenue Fund. As a result, the Boards and Commissions program expenditures in the General Fund are overstated and the Judiciary program expenditures in the Special Revenue Fund are understated by $4,799 in fiscal year 1987-88.

2. In fiscal year 1987-88, law library personnel made errors in recording accounts receivable and revenue relating to billings sent to users for legal research. As a result, Special Revenue Fund revenue is overstated by an estimated $7,962.

3. At fiscal year-end 1987-88, the Judicial Branch adjusted its records incorrectly for the estimated amount of the Judicial Branch's liability to employees for accumulated vacation and sick leave. As a result, the liability shown on the state's accounting records was understated by $11,158 at June 30, 1988.

4. As noted in the previous audit, the Judicial Branch does not record the law library book collection as a fixed asset on the state's accounting records as required by state accounting policy. The library collection represents a material and valuable unrecorded asset. Law library personnel recorded a portion of recent library purchases on the state's account-

ing records during fiscal year 1988-89. Personnel stated they intend to hire consultants at a cost of approximately $2,000 to estimate the value of the remaining collection when funds become available.

Most of the issues discussed above resulted from human error, improper segregation of duties, or a lack of funding. The Judicial Branch could avoid errors such as those involving federal expenditures and compensated absences by implementing more thorough review procedures to ensure all adjustments to SBAS are made correctly by fiscal year-end. The Judicial Branch could improve accounting control over law library transactions by providing additional accounting and SBAS training to library personnel preparing accounting documents and implementing procedures to provide experienced supervisory review and authorization of transactions. Management should also require that the person approving accounting documents not be the preparer of the documents. As an alternative, the Judicial Branch could consider combining the law library accounting functions under the Court Administrator's Office. Personnel indicated no additional personnel or funding would be necessary to provide the accounting services.

Recommendation B1-1

We recommend the Judicial Branch:

A. Implement procedures to ensure all financial activity recorded on SBAS is in accordance with state law; and

B. Provide SBAS training to and adequately segregate duties of law library personnel; or

C. Combine the law library accounting function under the Court Administrator's Office.

Response B1-1

Issue 1. We have corrected this problem.

Issue 2. We have corrected this problem.

Issue 3. We have corrected this problem.

Issue 4. We concur with the recommendation but no funding has been made available to pay for the costs of this project.

The Supreme Court accepted and implemented Recommendation C.

Federal Issues
Department of Institutions

B2-1.
Internal Control Weakness

The department's responsibilities include establishing and maintaining adequate systems of internal accounting and administrative controls. The objectives of a system of internal control are to provide management with reasonable, but not absolute, assurance that resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data are obtained, maintained, and fairly disclosed in management reports. Because of inherent limitations in any system of internal control, errors or irregularities may occur and not be detected. However, a good system of internal control reduces the risk of such errors or irregularities.

During our audit we noted weaknesses in the department's control systems over payroll and fixed assets. The significant weaknesses we noted and suggestions for strengthening controls are discussed in the following report sections.

Payroll Controls

Payroll controls affect the use of funds for personal services expenditures. The department's total budgeted personal services expenditures were $47 million in fiscal year 1986-87 and $47.9 million in fiscal year 1987-88, or about 67 percent of the department's total budget. Most personal services expenditures are paid with state funds, but some are paid with federal funds. The agencies where we noted control concerns regarding payroll expended federal funds for personal services during fiscal years 1986-87 and 1987-88 as follows: $81,592 from the U.S. Department of Education via subgrants through the Montana Office of Public Instruction (CFDA #84.002, #84.009, #84.010, #84.013, and #84.048) and $30,590.94 from the U.S Department of Justice (CFDA #16.550 and #16.560).

B2-1a.
Sick Leave

State law, section 2-18-601(9), MCA, defines sick leave as a leave of absence with pay for a sickness suffered by an employee or his immediate family. The use of sick leave is limited to the conditions outlined in the Montana Operations Manual, Policy 3-0310. These conditions include but are not

limited to illness, injury, medical examinations, and family care. Additionally, the department's sick leave policy requires the employee's supervisor to review and approve the use of sick leave. We noted the following instances which indicate the Montana State Prison has not complied with these laws and policies.

In one instance, sick leave was improperly used during the last two weeks of employment. The employee requested to use thirty-two hours of sick leave and completed the required leave request form. However, the employee noted "terminating" as his reason for the usage of sick leave credits. The reason for this employee's use of sick leave does not meet the conditions outlined in state policy and law. An agency official stated the employee's time sheet was processed as prepared using the sick leave because the time sheet and leave request form were approved by the employee's supervisor.

We noted two instances in which an employee used sick leave immediately prior to termination. The employees did not submit a properly approved leave request form in either case. We also noted an instance which occurred during 1981 in which an employee was allowed to use all his "Prior 1971" accumulated sick leave before terminating his employment. File documentation indicated he was using the time to secure other employment and housing.

State law provides termination pay for 25 percent of unused sick leave earned after 1970 and no termination pay for unused sick leave earned prior to 1971. A prison official stated the law encourages the use of sick leave prior to termination in that an employee who uses sick leave regularly receives a 100 percent payout but employees who don't receive only a 25 percent payout of their unused sick leave. Prison officials indicated they believe state regulations regarding sick leave payout penalize long-term employees, who have been conscientious regarding the use of sick leave. As a result, they believe the regulations encourage employees to compensate for this perceived inequity by using all their sick leave prior to termination.

We observed indications that sick leave abuse occurred at two other facilities within the department. The most apparent example of potential sick leave abuse occurred at the Montana Youth Treatment Center (MYRC) just prior to its sale. We compared MYTC payroll reports for the last two pay periods prior to its sale in January 1987 to the same two pay periods in 1985. We found that sick leave hours taken increased 92 percent in 1986 from the comparable pay periods in 1985. At the Montana State Hospital (MSH), the superintendent issued a memorandum to all staff outlining allowable procedures for using sick leave in an effort to curb sick leave abuse.

Department management should actively seek ways to effectively curb sick leave abuse. According to state policy, sick leave abuse is grounds for dismissal of an employee and forfeiture of the 25 percent payout of their unused sick leave.

Recommendation B2-1a

We recommend the department establish more effective internal procedures to ensure compliance with sick leave laws and policies.

Response B2-1a

Concur. The Department of Institutions has a very detailed internal control policy in place and in use. The examples mentioned in the audit were isolated instances where the internal controls set forth by policy were not adhered to. To correct the internal control deficiencies noted, the department provided inservice training to supervisors to ensure their understanding of sick leave policies. In addition, employees are being advised of the sick leave policy during their pre-service training. Management will take a more active role in enforcing the sick leave policy, and where necessary, take corrective action to ensure the policy is being followed.

B2-1b.
Time Sheet Authorization

A supervisor's signature was omitted from 5 of the 28 employee time sheets tested at the Montana State Prison. The department's internal control policy regarding payroll requires supervisors to approve employee time sheets as verification that employees worked the number of hours recorded on their time sheets and to assure that all time sheets have been completed by the appropriate time. The audit revealed that payroll is processed from the employee time sheets without obtaining the appropriate supervisor's authorizing signature so employees receive payroll warrants as scheduled. Without supervisor approval, the prison may pay employees for work not performed or charge personal service costs to inappropriate programs. The prison should improve procedures to ensure time sheets are signed by the appropriate supervisors.

Recommendation B2-1b

We recommend the department require the prison to improve procedures to ensure compliance with department policy regarding time sheet authorization.

Response B2-1b

Concur. It is the policy of the Department of Institutions that no time sheet be processed unless it has been approved and signed by appropriate supervisory personnel. The Warden at Montana State Prison has already taken management action to ensure this policy is followed. In addition, the department met with key management personnel to clarify and place emphasis on the importance of following and enforcing the department's payroll policy.

B2-1c.
Fixed Asset Records

State policy requires state agencies to manage and account for the state's investment in fixed assets. It also requires state agencies to record fixed assets at cost, to assign each item a property number and to tag the item with a matching numbered tag. At June 30, 1988, the department's accounting records reflect a total of $75 million in fixed assets ($64 million in buildings, land, and other improvements and $11 million in equipment). About 45 percent of the department's recorded fixed assets are on MSP's accounting records. During fiscal years 1986-87 and 1987-88, the department purchased equipment with both state and federal funds. The federal equipment expenditures were: $67,574 from subgrants received through other agencies from the U.S. Department of Justice (CFDA #16.579 and #16.581); $11,654 from the U.S. Department of Education via subgrants through the Office of Public Instruction (CFDA #84.048 and #84.151); and $1,551 from the U.S. Department of Health and Human Services (CFDA #13.992).

We performed tests at selected department facilities to determine whether purchased items were recorded on the fixed asset records and whether the items were tagged. The results from four of the facilities are shown below. These four facilities report 48 percent of the department's fixed assets in the General Fixed Asset Account Group.

FIXED ASSET TEST RESULTS

Location	# tested	# not tagged	# not recorded
MDC	10	4	2
MSH	5	3	3
ICO	5	1	4
MVH	2	2	2
Total	22	10	11

In addition to the observations documented above, we noted instances at the prison in which fixed assets were not tagged with identification numbers; not recorded on fixed asset records; recorded on fixed asset records with incorrect quantities, costs,

descriptions or locations or not properly deleted from fixed asset records. In addition, the prison does not record fixed asset additions and deletions in a timely manner. We noted instances in which fixed asset additions and deletions were recorded on the prison's fixed asset records from two months to two years after the related purchase or disposal of the fixed asset.

In November 1988, we also found that $8,300 of property purchased between March 1 and June 30, 1988, had not been recorded on the Montana Developmental Center's (MDC) fixed asset records, although the items had been tagged and listed on an input form for entry onto the fixed asset records. We also noted two instances at MDC where documents to enter fixed assets onto the fixed assets records were lost or misplaced.

Department personnel cited lack of communication between those ordering and receiving equipment and employees maintaining equipment inventory records, insufficient staff time to keep equipment inventory current, and the low priority assigned to tagging equipment by department management as reasons why equipment was not recorded or tagged.

The number and type of errors noted during the audit indicate that additional training in and review of state property accounting policies may be necessary to help eliminate similar errors in the future.

Recommendation B2-1c

We recommend the department:

A. Provide personnel additional training in state property accounting policies and implementation of these policies.

B. Implement procedures to facilitate timely recording of equipment on the property records.

C. Ensure equipment is tagged as required by state policy.

Response B2-1c
Concur.

A. Key personnel have attended classes on the Property Accounting and Management System as required. In addition, line supervisors have been advised of their responsibilities in the day to day accountability for state equipment.

B & C. It is department policy that equipment be recorded and tagged as required by state policy. The department will place additional emphasis on the enforcement of this policy. In addition, effective immediately, supervisory warehouse personnel will spot check equipment after it is received to ensure it has been properly recorded, tagged, and is located in the area reported on PAMS or SIMS.

B2-2. Veterans' Administration Reimbursements

The Montana Veterans' Home (MVH) submits a quarterly expense report to the Veterans' Administration (VA) for care of MVH residents (CFDA #64.015). At the same time, MVH bills the VA for per diem at the appropriate domiciliary and nursing home rates based on occupancy records. Central Office usually

receives the reimbursement within a month after the end of the quarter. Through inquiry of institution management and review of federal regulations, we determined that MVH was not limited to reimbursement on a quarterly basis. Therefore, MVH could draw funds from the VA more frequently.

In response to an issue raised in our last audit at MVH, accounting personnel obtained interentity loans of $140,000 in April 1987 and $217,441 in June 1988 to enable the department to properly record expenditures in the Special Revenue Fund at fiscal year-end. We analyzed the cash use in the federal accounting entity and determined that the department borrowed more cash from the General Fund than was needed to meet the anticipated expenditures of the fourth quarter of fiscal years 1986-87 and 1987-88. MVH personnel borrowed an amount based on an estimate of quarterly reimbursement without adjusting for cash already on hand. As a result, the MVH borrowed approximately $95,000 more than needed each fiscal year.

Section 17-2-108, MCA, requires the department to expend non-general fund money wherever possible before using general fund appropriations. More frequent cash draws should reduce the need for interentity loans and improve cash management at MVH. We estimate the present schedule of drawing VA funds cost the General Fund $3,783 and $5,756 in lost interest during fiscal years 1986-87 and 1987-88, respectively. In addition, accounting personnel prepare lengthy adjustment documents to move transactions between funds in an attempt to comply with the requirement of state law. By drawing VA cash more often, the time expended in making these adjustments can be applied to other tasks.

Recommendation B2-2

We recommend the department draw VA funds more frequently to alleviate cash flow problems at MVH.

Response B2-2

Concur. The Montana Veteran's Home is now drawing VA funds on a monthly basis.

B2-3. Non-General Fund Expenditures

In addition to the problems associated with VA funds (CFDA #64.015) described in the preceding section, we found instances at other locations within the department where non-general fund money was not spent before general fund money to the extent possible and reimbursable expenditures were not recorded in accordance with state accounting policy.

1. Montana State Prison did not record expenditures in the Special Revenue Fund for the full amount of the federal boarder reimbursement (CFDA #16.999). As a result, expenditures were understated in the Special Revenue Fund and overstated in the General Fund by $44,827 in fiscal year 1986-87. Prison personnel corrected the accounting records for this error in fiscal year 1987-88.

2. Swan River Forest Camp did not record expenditures in the Special Revenue Fund for the full amount of the federal boarder reimbursement (CFDA #16.999) or for the School Breakfast and Lunch programs (CFDA #10.553 and #10.555, respectively). As a result, expenditures were understated in the Special Revenue Fund and overstated in the General Fund by $6,036 in fiscal year 1987-88.

In both cases described above, agency personnel responsible for the transactions were new to the department and not aware of the procedures for recording this activity. One employee expressed interest in obtaining additional training in state accounting policy, but said the training was offered in half day increments in Helena that did not accommodate the workload of his facility.

Central Office personnel also recorded all audit costs in the General Fund in fiscal year 1987-88, although spending authority and cash were available in non-general fund entities. These costs should have been split on a percentage basis between nine appropriations: one in the General Fund, five in the Special Revenue Fund, and three in the Internal Service Fund. As a

result of not allocating audit costs properly, expenditures were understated by $1,401 and $728 in the Special Revenue Fund and Internal Service Fund, respectively, and overstated by $2,129 in the General Fund.

Recommendation B2-3

We recommend the department ensure non-general fund money is spent before general fund money to the extent possible, as required by state law.

Response B2-3

Concur. The department carefully monitors non-general fund accounts on a monthly basis to ensure the money in those accounts is spent prior to General Fund money.

B2-4. Revenue and Expenditure Recognition

Generally accepted accounting principles (GAAP) and state law and policy provide guidelines for recording revenue and expenditures. During our review of department accounting records, we noted the following instances which were not in compliance with GAAP and state accounting law and policy.

1. The department improperly records revenue for Medicaid (CFDA #13.714) reimbursements in the General Fund that are transferred from the Department of Social and Rehabilitation Services (SRS). Because the moneys are transferred from one state department to another, the transactions should be recorded as transfers in rather than revenue at the Department of Institutions. As a result, transfers in are understated and revenues are overstated on the state's accounting records by $3,867,805 in fiscal year 1986-87 and $4,040,509 in fiscal year 1987-88.

   The department did not record $788,385 in Medicaid reimbursements earned during fiscal year 1986-87 in its General Fund. The department reduced its reimbursement accrual at the request of SRS personnel when SRS exhausted its appropriation authority for Medicaid state matching funds. Since the federal portion of the reimbursement funds was

not recorded as General Fund revenue by the department, the state's General Fund balance was understated by $521,687 at fiscal year-end 1986-87. State law and generally accepted accounting principles require that revenue and transfers in be recorded in the year in which the corresponding service was provided. Regardless of action taken by SRS, the department should have accrued the reimbursement earned.

A possible long term solution to this problem would be for the legislature to appropriate only the federal portion of the medicaid reimbursement at SRS and appropriate General Fund match at each institution. The Governor's budget for the 1991 Biennium proposed this approach.

2. At fiscal year end 1986-87, Montana Veterans' Home personnel made an entry recording payments owed by the Veterans' Administration (CFDA #64.015) but not yet received as deferred revenue in the Special Revenue Fund. Since the payments are calculated on a per diem rate and paid on a reimbursement basis, the revenue was actually earned during fiscal year 1986-87 and should not have been deferred. State accounting policies require revenue earned in a Special Revenue Fund to be recorded when the revenue is measurable and available. As a result of this error, revenue was understated and deferred revenue was overstated by $128,931 in the Special Revenue Fund during fiscal year 1986-87.

3. Prison ranch accounting personnel record raw milk sales to a private company as revenue for the net amount of cash received. The total sales are reduced by expenses associated with hauling charges, marketing charges, dairy products commission, national promotion board fees, commodity credit assessment, and supplies. The purchaser then remits the net sales amount to MSP. The sales contract does not specify whether the seller or buyer is obligated for the deductions taken, but the substance of the transaction is that the prison pays for the deductions. Therefore, the prison should recognize the total sales amount as revenue and recognize the related deductions as operating expenditures.

   As a result of this procedure, expenditures and revenue in the Internal Service Fund were understated by $60,209, $76,896, and $80,631 during fiscal years 1985-86, 1986-87, and 1987-88, respectively. In addition, we noted the prison

would have overexpended its appropriation authority by $2,773 during fiscal year 1987-88 had these sales been recorded in accordance with state law and GAAP. Prison officials stated the current contract and procedure was common practice within the milk industry.

4. The Montana Developmental Center received supplies during April of 1987. Accounting personnel did not pay for and record the expenditure related to these supplies until fiscal year 1987-88. At that time, the center properly recorded the payment as a prior year expenditure. Consequently, expenditures in the General Fund were understated by $6,136 during fiscal year 1986-87 and the center lost a cash discount of $123.02 by not paying for the supplies in May 1987.

5. Montana Developmental Center employees accrued a liability for services not received by fiscal year-end. State accounting policies require services to have been rendered during the year in which the anticipated expenditure is accrued. As a result, expenditures and accrued expenditures were overstated in the General Fund by $2,910 during fiscal year 1986-87.

The above errors resulted from employee misunderstandings regarding year end accruals and proper revenue and expenditure recognition, inadequate review procedures, untimely payments, and human error.

<u>Recommendation B2-4</u>

We recommend the department develop more effective procedures to ensure:

A. Year-end accruals are adequately reviewed for accuracy; and

B. Revenues and expenditures are properly recognized and recorded in a timely manner in the appropriate fiscal year.

Response B2-4
Concur.

A. The department's accounting supervisory staff carefully review all accruals at fiscal year end to ensure their appropriateness and accuracy. In addition, accounts payable files are reviewed on an ongoing basis to ensure all invoices are either processed in a timely manner, or if necessary accrued.

B. Effective July 1, 1989, the department receives only federal Medicaid reimbursement from the Department of Social and Rehabilitation Services. The department's General Fund expenditures will be treated as the necessary state match to the federal Medicaid funds. In addition, effective July 1, 1989, the department will no longer record Medicaid reimbursement as revenue, but instead, will record it as "transfers in".

In fiscal year 1988 the Montana Veteran's Home began recording the final quarter of each years Veteran's Administration reimbursement as accrued revenue as opposed to deferred revenue. The MVH, therefore, is now recording revenue when it becomes measurable and available in the fiscal year it is earned, as required by state policy.

The Montana State Prison ranch will record the total sales amount for milk as revenue. The expenses associated with hauling, marketing, dairy products commission, national promotion board fees, commodity credit assessment, and supplies will be recorded as expenditures, and not as a reduction to revenue.

B3-1. Administrative Cost Recovery

Federal regulations allow state agencies to be reimbursed for all indirect costs necessary for the administration of federal grants. State law (section 17-3-111, MCA) requires state agencies to recover indirect costs of federal assistance programs to the fullest extent possible. Recovery of indirect cost reduces the amount of state money required to support federal programs. In calculating the indirect cost recovery rate for fiscal years 1986-87 and 1987-88, the department did not include the cost of an audit and other allowable indirect costs (Child Support Program - CFDA #13.783 and Royalty Audit Program - CFDA #15.999). Department officials were not aware that the costs of audits and other indirect costs were allowable and eligible for reimbursement. As a result, an additional $26,080 of state money was spent for program administration during the two fiscal years of the audit period. The department should include audit costs and all indirect costs necessary for the performance of a federal program in its calculation of an indirect cost recovery rate.

Recommendation B3-1

We recommend the department recover indirect costs to the fullest extent possible in accordance with state law.

Response B3-1

All allowable indirect costs were included in the FY 1990 Indirect Cost Proposal. The federal Department of Health and Human Services denied including in the cost proposal prior years indirect costs that had not been claimed in the past.

Federal Issues
Department of Military Affairs

B4-1.
Accounting Issues

During our audit of the Department of Military Affairs, we noted five accounting issues that reduce the reliability of the accounting information produced by the Statewide Budgeting and Accounting System (SBAS) for the department. The issues relate to staff training and communication of information and responsibilities within the department and are detailed in the sections that follow.

The department receives federal financial assistance from two federal agencies, the U.S. Department of Defense Air and Army National Guard and the Federal Emergency Management Agency (FEMA). The department reported expenditures of $1,727,515 and $1,915,331 in fiscal years 1986-87 and 1987-88, respectively for the Department of Defense. The Air and Army National Guard moneys were not included in the scope of our audit of federal compliance. The U.S. Department of Defense makes its own audits of National Guard funding to the department. FEMA expenditures, from nine separate federal assistance programs, totaled $1,937,347 and $1,123,698 in the two fiscal years, respectively. The following report sections may have an affect on any or all of these federal programs.

B4-1a.
Revenue Accruals

Fund balances, both negative and positive, improperly existed in each of the department's six federal special revenue fund accounts at fiscal year-end 1986-87 and in four of the six at fiscal year-end 1987-88. Federal special revenue funds record activity related to the receipt and disbursement of money for which the federal government specifies the use of the money. Following state accounting policies and generally accepted accounting principles (GAAP) would result in all of the department's federal special revenue funds identified above having a zero fund balance at fiscal year-end. The fact that fund balances exist in these funds indicate errors are present in the accounting records.

Our testing indicates the improper fund balances are primarily the result of failure to accrue revenue at fiscal year-end in these accounting entities. As a result of the failure to properly accrue revenue the accounting records are misstated by:

Special Revenue Fund

	Revenue Over(under)stated	Fund Balance Over(under)stated
FY 1986-87	$(181,588)	$(181,588)
FY 1987-88	$(131,089)	$(131,089)

We have identified the revenue accrual problem in each of our last three audits of the department (covering fiscal years 1980-81 through 1985-86). The department concurred with our recommendations in each of the audits.

Recommendation B4-1a

We recommend the department:

A. **Accrue revenue in accordance with state accounting policy.**

B. **Review fund balances in the federal special revenue accounting entities to detect and correct errors.**

Response B4-1a

We concur. The department will follow state accounting policy when accruing revenue, and review fund balances in the respective entities to ensure their accuracy. We will comply, beginning with this years fiscal year end process.

B4-1b.
Expenditure Reductions

In fiscal year 1988-89, the department processed documents that improperly reduced expenditures to avoid a negative cash balance in one accounting entity. Section 17-2-107, MCA, states that when the expenditure of an appropriation is necessary

and the cash balance from which the appropriation was made is insufficient, the Department of Administration may authorize a transfer, as a temporary loan bearing no interest, provided certain conditions are met. We noted three instances where expenditures totaling $237,660 were improperly reduced. Department personnel stated that these transactions are reversed when reimbursements for the expenditures are received from the federal government. The improper reductions have no effect on the financial schedules for fiscal year 1986-87 or 1987-88. Department personnel stated the expenditures were reduced to avoid a negative cash balance in the federal accounting entity in which the expenditures were initially recorded. The use of an interentity loan would properly state the balances for cash and expenditures on SBAS.

Recommendation B4-1b

We recommend the department obtain interentity loans pending federal reimbursement of its expenditures.

Response B4-1b

We concur. The department will obtain interentity loans as necessary.

B4-1c.
Expenditure Accrual

At fiscal year-end 1986-87 the department improperly accrued an expenditure of $21,500 for construction of a portion of the veterans' cemetery. State policy indicates expenditures should be accrued if a valid obligation exists at fiscal year-end. A valid obligation, in this case, would have been evidenced by a signed construction contract. However, the contract was not signed until three months after June 30, 1987. The improper accrual overstates expenditures in fiscal year 1986-87. Agency personnel indicated they accrued the expenditure because they were sure the contract would be let and signed in the future. This does not represent a valid obligation as of June 30, 1987.

Recommendation B4-1c

We recommend the department accrue expenditures in accordance with state accounting policy.

Response B4-1c
We concur. We will take appropriate measures during the fiscal year end process to comply with the recommendation.

B4-1d.
Construction Work in Progress and Construction Advances

The department does not record construction work in progress (CWIP) or construction advances in accordance with state accounting policy. These problems were noted in each of our previous three audits. The department concurred with our recommendations in each of those audits, but has not implemented our recommendations.

State accounting policy related to CWIP requires construction projects not completed as of fiscal year-end be recorded as construction work in progress. In fiscal year 1986-87, department personnel prepared documents to record CWIP on the accounting records. The department submitted the documents to the Department of Administration for processing but did not review to ensure the documents were processed and recorded correctly. In fiscal year 1987-88 department personnel recorded most construction projects not completed at fiscal year-end as buildings rather than CWIP. CWIP is understated by approximately $600,000 in fiscal year 1986-87 and approximately $370,000 in fiscal year 1987-88. Due to recording problems at the department it was not cost efficient to determine the amount of misstatement in the buildings account. Department personnel indicated they have little training and do not understand the procedures for recording CWIP.

Our findings related to construction advances were related to a construction project on the veterans' cemetery. The legislature appropriated $50,000 to the department in the federal special revenue fund for a state veterans' cemetery. When money is appropriated to an agency for a construction project, the agency is responsible for recording certain transactions on its accounting records. Department personnel assumed that because the Department of Administration, Architecture and Engineering (A & E) Division had obtained an administrative appropriation to pay the construction bills as they came due and was depositing and recording the checks, that no recording was required on the department's records. As a result, the department has no record of revenues, expenditures or construction advances for the veterans' cemetery on its accounting records. Revenues and expenditures are understated by $28,436 in fiscal year 1986-87 and $21,559 in fiscal year 1987-88.

State accounting policy requires the department:

- Record money received from the federal government as revenue on the department accounting records;

- Record money transferred to A & E as construction advances; and

- Reduce the construction advance and record expenditures for money spent by A & E at fiscal year-end.

Department personnel stated they were not aware of state accounting policy requiring the use of the construction advance when the appropriation for a construction project was to the department. They also stated that because A & E recorded all revenue and expenditure activity and the checks were payable to the State of Montana it was reasonable to send the checks directly to A & E.

Recommendation B4-1d

We recommend the department record construction transactions in accordance with state accounting policy.

Response B4-1d
We concur. The department will comply with the recommendation from this point forward.

B4-1e.
Consolidation of Agencies

The department has not transferred the financial information from two inactive agencies to the agency they now use for recording financial information. In order to promote the maintenance of accurate financial information the department, in fiscal year 1985-86, implemented a partial reorganization plan which centralized some of the accounting functions of the department's various divisions. Consolidation of state accounting records into one agency instead of three was a part of the plan. At fiscal year-end 1986-87 and 1987-88 the department still carried balances in the financial records of the two agencies to be eliminated.

The account balances that should have been closed represent receivables and payables that are no longer collectible or payable or that have been collected and paid in another agency. These balances result in a misstatement of fund balance, in the special revenue fund, of $28,013 at fiscal year-end 1985-86, 1986-87, and 1987-88 and contributed to a qualification of our opinion on the department's financial schedules. There were also fixed asset equipment balances remaining that should be transferred to the single agency now being used.

Department personnel stated the financial information carried for the inactive agencies was not transferred because it was believed that a transfer was improper since carry over of appropriations remained in these areas. Based on our review of the

accounting records, elimination of the balances carried in the closed agencies would not have any effect on appropriations.

Recommendation B4-1e

We recommend the department properly eliminate account balances in the agencies which are no longer used.

Response B4-1e
We concur. We will eliminate account balances in the respective agencies by June 30, 1989.

B4-1f. Summary

All of the accounting issues listed above result from two causes.

- Inadequate training of staff involved in the accounting functions.
- Lack of central control or oversight over the accounting functions.

Both causes were addressed in recommendations in the report on our last audit of the department. Department staff have received some training since our last audit; however, based on the number of findings in our current audit, additional training is still required. The number and cause of the findings noted in our current audit indicate a need for more communication between the personnel involved in the accounting functions of the various divisions. Examples of situations where communication may reduce accounting errors include:

- The property manager attempted to record the construction work in progress (CWIP) transactions on the accounting records in fiscal year 1986-87. When the documents did not properly process onto the system, communication broke down and, as a result, most of the CWIP transactions were not recorded.

- Accounts that were to be closed in fiscal year 1984-85 have remained open through fiscal year-end 1987-88 because it was not clear who was responsible for reviewing and closing the accounts.

- Federal special revenue fund accounts had fund balances at the end of fiscal years 1986-87 and 1987-88 because it was not communicated who was responsible for reviewing and ensuring appropriate accounts had a zero fund balance.

We have noted similar communications problems in each of the last two audits of the department. The department concurred with these recommendations.

Recommendation B4-1f

We recommend the department:

A. Provide personnel additional training in state accounting policy and fund accounting.

B. Establish policies and procedures to improve communication of information and responsibilities between the various division's accounting functions.

C. Ensure accounting entries recorded by the individual divisions result in proper recording on the department's accounting records.

Response B4-1f

We concur.

A. We will make a concerted effort with the funds available and state training resources available to provide training for staff. This will be an ongoing procedure and begin immediately.

B. We will work during the next year to establish an integrated accounting function within the department.

C. We will ensure through better communication and training that accounting entries are recorded properly.

B5-1. Federal Section 8 Housing

B5-1a. Rental Unit Inspections

Federal regulations require that 5 percent of the annual inspections of Section 8 Housing (CFDA #14.156) rental units be reinspected for quality control purposes. The reinspection is designed to provide assurance the inspectors follow inspection guidelines. Section 8 personnel did not complete the required reinspection for fiscal years 1987-88 and 1988-89. Section 8 personnel stated they had formally requested and received a waiver of this requirement due to lack of resources and computer system implementation problems. However, personnel could not produce documentation of the waiver and HUD officials stated they had no record of the request for a waiver.

Department personnel have indicated they began the reinspection process in August 1989 with completion set for November 1989. The department should establish priorities to ensure the reinspections are completed each year in accordance with federal regulations. This issue did not cause us to question the allowability of costs for federal reimbursement.

Recommendation B5-1a

We recommend the department comply with the Section 8 reinspection regulations.

Response B5-1a

The department concurs. As of November 1989, the department has completed the reinspections for fiscal year 1989. The reinspections for fiscal year 1990 are scheduled and will be accomplished in the summer of 1990.

B5-1b.
Accounts Receivable

In our prior audit report we recommended the department record accounts receivable for overpayments of Section 8 Housing Assistance (CFDA #14.156). At fiscal year-end 1988-89, Section 8 requested Management Services Division to record $19,654 of accounts receivable on the accounting records. We reviewed the support for this transaction and determined Section 8 should have requested recording receivables totalling $58,172 with an allowance for uncollectible accounts of $11,255. The end result is that net receivables at June 30, 1989, are understated by $27,263. The Montana Operations Manual Section 21100.120 requires all bona fide receivables be recorded on the accounting records.

Section 8 personnel informed us the receivables can occur in three ways:

1. Section 8 personnel send a housing assistance payment to a landlord in error. This occurs when a tenant vacates the rental unit and does not notify Section 8 in time to stop the next assistance payment. Section 8 notifies the landlords and requests them to return the overpayments.

2. Section 8 may overpay landlords because the tenant provided incorrect financial information; e.g. the tenant may claim a lower income than is actually the case. Tenants are liable for this type of overpayment. Section 8 personnel attempt to notify the tenants and seek reimbursement for these overpayments.

3. Federal Housing regulations allow Section 8 to cover damages incurred to a rental unit by a tenant. Regulations also allow the Section 8 to seek reimbursement for these damage expenses from the tenants.

Section 8 has a computer system which could be more actively used to track the receivables described above. Personnel were unable to identify what amount of the $58,172 receivable related to overpayments and what amount related to damage expenses.

Section 8 personnel indicated they were unfamiliar with the receivables portion of the computer system as the former administrator had not provided the necessary training. The present administrator informed us the clerical personnel would receive the training necessary to monitor and account for the receivables discussed above.

Recommendation B5-1b

We recommend the department:

A. Record all accounts receivable for Section 8 Housing Assistance overpayments and damage expenses.

B. Provide training on the housing assistance computer system to Section 8 personnel.

Response B5-1b

The department concurs.

A. All accounts receivable will be accurately recorded on SBAS at fiscal year end 1990.

B. Staff training was conducted in April 1990, with the accounts receivable recording and tracking being a fundamental part.

B5-2. CDBG Performance and Evaluation Report

The department prepared a Performance and Evaluation Report for the fiscal year ended June 30, 1988 on the fiscal year 1986-87 Community Development Block Grant (CDBG) award (CFDA #14.228). We reviewed this report as it was the most recent one compiled by the department at the time of our fieldwork. The report contains general CDBG information as well as more detailed information for the 17 projects in process. We verified financial information for the grant as a whole and for 5 of the individual projects.

We noted the department included an August 1, 1988 cash drawdown in the report. As the report was dated June 30, 1988, this drawdown should not be included. Inclusion resulted in the total fiscal year 1987-88 drawdowns reported being overstated by $192,750. CDBG personnel indicated this error was caused by an oversight during their review. This error did not cause us to question the allowability of any costs for federal reimbursement.

Recommendation B5-2

We recommend the department ensure correct and consistent information is included in the CDBG Performance and Evaluation Report.

Response B5-2

The department concurs. Beginning with the 1989 report, there was a double-check instituted on the report, by having the Management Services Division review the report after it is prepared by the Local Government Assistance Division, prior to submitting the report to HUD.

B6-1. Internal Controls

The department receives Federal Highways Planning and Construction Grant (CFDA #20.205) moneys to aid in the construction of federal aid highways. During our examination in the last audit, we noted two instances where documentation of the existence of internal controls related to this grant was lacking. Our follow-up indicated documentation has not significantly improved.

Documentation of Project Estimate Controls

Major highway construction projects are supervised by a field project manager. The field project manager is responsible for preparing a project estimate, which is used to generate payments to contractors for the work completed. We identified the field project manager's review and approval of the completed project estimate as one of the key controls in the contractor claims section of the expenditure cycle. Our testing, in the last audit, disclosed that the field project manager was no longer signing the project estimate as evidence of the control.

Our current audit testing indicates the department has not established a uniform policy requiring project managers to review and approve the progress estimates used for payments to contractors. We interviewed and/or examined workpapers from 17 field project managers. Ten of the field project managers involved were not aware of the policy. As a result we could not conclude the prior audit recommendation had been implemented.

Project estimate information is submitted by the field project manager through a series of verbal, manual, and/or electronic processes. There is a potential for errors to occur at each stage of the processing. Since the field project manager is on site at the project and is the one preparing the original estimate, the field project manager is the individual with the best opportunity to compare input to output and detect errors in a timely manner. If errors occur and are not detected in a timely manner they

could result in overpayments to contractors that may not be detected for several years.

Department personnel indicated this control was overlooked when a major change in the project estimate system was implemented. Since our last audit the attempts to implement this control had been on a district by district basis. The district by district approach resulted in less than complete implementation of this control. It appeared the department did not emphasize the importance of this review and approval control. Department personnel indicated increased emphasis will be placed on this control in the future.

Documentation of Equipment Usage Report Controls and Questioned Costs

The department's equipment management system does not ensure all equipment usage reports are reviewed and approved. The department uses the system to develop management information and bill projects for equipment use. The input for this system is an equipment usage report, prepared by the operator of the equipment, detailing what projects should be charged for the equipment's use. Department policy requires supervisors review and initial reports to indicate the approval of charges to the various projects. This review and approval is designed to ensure accurate charges to projects on which the equipment was used.

Our sample testing, of fiscal years 1987-88 and 1988-89 transactions, at department headquarters, revealed 15 equipment usage reports out of 103 tested that were not signed by the supervisors. We also found 5 equipment usage reports out of the 103 that could not be adequately supported by the department as federal project charges. Two of the five were not signed as approved by the supervisor. These five items resulted in our questioning $244 of costs charged to federal projects. Department personnel indicated equipment usage charged to federal projects for all districts amounted to $711,654 and $782,390 in fiscal years 1987-88 and 1988-89 respectively. We followed up on the results of our sample at all five district offices. We found if signatures were present on the equipment usage reports

(less than 50 percent were signed at most districts) they often were signed by office or supervisory personnel who had little or no knowledge of the accuracy of the information on the usage report.

Department personnel indicated the lack of signatures was due to confusion over which supervisor should approve the reports and what the review should include. They also indicated that new emphasis will be given to this control in the future.

Recommendation B6-1

We recommend the department:

A. Implement policies requiring review and approval of project estimates and equipment usage reports; and

B. Implement procedures to ensure all equipment usage charged to federal projects is adequately supported.

Response B6-1

A. We concur. As the auditors noted, the department implemented a new personal computer based project estimate system in 1987. The department's training regarding the internal control procedure discussed by the auditors apparently was not adequate due to the complexity of the change. We have redesigned the project estimate to require a signature on the completed report certifying the project manager has reviewed the completed project estimate form and the quantities submitted were accurately processed. The Construction Bureau issued a memorandum on November 28, 1989, explaining the new form and established this procedure as a formal policy. The revised

Construction Manual will also include this procedure and the department will review project estimates in the field by several district and headquarters personnel to assure compliance.

B. We concur. The Equipment Bureau redesigned the equipment usage reports after the auditors notified us of the deficiency. This report requires a review and approval signature. The Accounting and Equipment Manuals also state the proper policy and procedure. We will emphasize this requirement during additional field training.

B7-1. Classification of Revenue

Objects of revenue, established by individual agencies, identify the type of receipt transaction and applicable budgetary control account transaction. Statewide revenue classifications represent the revenue summarization to which revenue estimates and objects of revenue are assigned by the Accounting Division. The statewide revenue classification provides the receipt information necessary to ascertain detailed financial information relative to moneys received and subsequently deposited into the State Treasury System.

During our audit, we noted several objects of revenue assigned to an inappropriate revenue class during fiscal years 1987-88 and 1988-89. The following tables identify the misstatements by object of revenue, fund, fiscal year, and revenue classification.

Table 1

Object of Revenue Misclassification

Object of Revenue/Fund	Assigned Revenue Class		Appropriate Revenue Class	
	1987-88	1988-89	1987-88	1988-89
General				
Fee for Substitute Judges	Invest. Earnings	Invest. Earnings	Chgs for Svcs	Chgs for Svcs
Misc. Receipts - Gen	Chgs for Svcs	Chgs for Svcs	Miscellaneous	Miscellaneous
National Forest Fees (CFDA #10.999)		Licenses & Permits		Federal
Special Revenue				
Approp. Transfers - Gen	Chgs for Svcs	Chgs for Svcs	Other Financing Sources	Other Financing Sources
Misc. Receipts - Gen		Chgs for Svcs		Miscellaneous
Debt Service				
Approp. Trans. - Gen	Chgs for Svcs	Chgs for Svcs	Other Financing Sources	Other Financing Sources
Misc. Receipts - Gen		Chgs for Svcs		Miscellaneous
Internal Service				
Property Ins. Reim.	Chgs for Svcs	Chgs for Svcs	Miscellaneous	Miscellaneous

Source: Compiled by the Office of the Legislative Auditor.

Table 2

Revenue Classification Misstatements

	Fiscal Year 1987-88 over(under)stated	Fiscal Year 1988-89 over(under)stated
General Fund		
Licenses and Permits		$156,725
Charges for Services	$158,433	22,058
Investment Earnings	23,000	33,459
Miscellaneous	(181,433)	(55,517)
Federal (CFDA #10.999)		(156,725)
Special Revenue Fund		
Charges for Services	$147,898	$154,633
Other Financing Sources	(147,898)	(153,994)
Miscellaneous		(639)
Debt Service Fund		
Charges for Services	$ 31,961	$811,978
Other Financing Sources	(31,961)	(196,548)
Miscellaneous		(615,430)
Internal Service Fund		
Charges for Services	$200,000	$ 10,930
Miscellaneous	(200,000)	(10,930)

Source: Compiled by the Office of the Legislative Auditor.

Department personnel indicated misclassifications were due to human error; sometimes it is difficult to judge which revenue class is proper. Accounting Division personnel indicated they review the objects of revenue and class but they do not question the agency unless it is obviously incorrect.

Recommendation B7-1

We recommend the department improve review procedures and ensure each object of revenue is assigned to the appropriate statewide revenue classification.

Response B7-1

We concur. The Department has corrected misclassified objects of revenue, and Management Support Bureau will begin reviewing requests for new objects of revenue department-wide to ensure proper classification.

B7-2. Electronic Data Processing

The Office of the Legislative Auditor annually conducts a central review at the Information Services Division (ISD) and the Accounting Division. The review examines controls over the mainframe computer operated by ISD and specific controls related to systems which operate on the mainframe computer. The systems include the Statewide Budgeting and Accounting System (SBAS) and Property Accountability and Management System (PAMS) maintained by the Accounting Division.

We identified weaknesses with controls over the systems tested. These weaknesses could significantly affect the state's ability to carry out program objectives in accordance with state and federal requirements (for the programs listed on the Schedule of Federal Financial Assistance, starting on page 2 of this report). The following sections discuss these weaknesses and include recommendations to the department.

B7-2a. Telecommunications Recovery and Security Controls

During our prior financial-compliance audit, we identified weaknesses in the department's security and recovery controls. These weaknesses included inadequate physical security over telecommunications equipment which is located adjacent to a cafeteria in the basement of the building, and no written disaster recovery plan to ensure the continuity of telecommunication services and operations after major destruction of equipment.

During our current audit, we performed a follow-up review to determine whether these weaknesses were corrected. The department installed new doors and electronic entrances to improve security over equipment. The telecommunications equipment was not moved nor has the cafeteria changed loca-

tions, leaving the possibility of smoke, water, or fire damage to the equipment. The Telecommunications Bureau does not have any off-site storage of its data and programs. The only backup performed is by ISD on its resident disk backup. This backup is not intended for specific application backup use; rather, it is for ISD's own purposes. The department has a partially written disaster recovery plan, but as of October 1989 it was not finalized. The Information Services Division hired a CPA firm to perform a security recovery analysis and evaluate the department's security controls. Department personnel indicated the firm's recommendations are being considered for the disaster recovery plan.

The Information Services Division's Telecommunication Bureau manages the state's telephone system. If the equipment were damaged, the state could incur significant costs as a result of state personnel not able to communicate in a timely manner, in addition to the costs necessary to repair and/or replace the damaged equipment. A finalized disaster recovery plan and adequate security over the equipment would reduce these potential costs. The value of the telecommunications equipment located in the basement is conservatively estimated at over $3.5 million. The replacement cost for this equipment in the event of major disaster would be considerably higher than the value of the equipment.

Recommendation B7-2a

We recommend the department:

A. Finalize a telecommunication disaster recovery plan.

B. Provide adequate physical security over telecommunications equipment.

Response B7-2a

A. We concur. The Information Services Division completed its draft of a disaster plan in November 1989. This plan is a beginning for addressing recovery from disasters. Disaster teams and agreements with telecommunications vendors are being negotiated to improve our ability to respond in the event of a major disaster. However, because foolproof disaster recovery entails very costly redundant equipment and circuitry, we believe investments in prevention against disasters is more cost effective.

B. We concur. The best method to provide security for telecommunications equipment is to build a secured building to house all of the division's telecommunications and computing facilities. A structure of this type would provide controlled access to our major systems, proper earthquake protection, improved fire protection and would eliminate the risk of disaster from water (our most likely cause of a major disaster). A budget request for a new facility of this type will be considered. The department has already taken actions to improve the security of the current facility, such as replacing hollow core doors with steel cased doors, as an interim measure.

**B7-2b.
SBAS Access**

Computer access controls help prevent unauthorized use of the data files. Access controls are physical or electronic safeguards designed to ensure computer system resources are properly used. These controls consist of input controls instituted for each application as well as access controls governed by ACF2, the state's mainframe computer security software.

We reviewed the department's ACF2 access rules over SBAS. Current ACF2 rules allow computer programmers access to write to SBAS data files. These programmers maintain the SBAS programs for the Accounting Division. On occasion, Accounting Division personnel request programmers to correct problems in the data files. However, programmers do not normally require access to data and should not have unlimited ability to

change data. Routine access to data by employees who do not need such access to perform their job increases the risk that data will be altered without proper authorization.

In addition to providing access rights, ACF2 can be used to log access to computer programs and data. Accounting Division personnel do not use ACF2 to record when the programmers write to the SBAS data files. Without logging and controlling programmer access to data, Accounting Division personnel cannot be assured the programmers make only authorized changes to the data files.

During our 1988 central review, we recommended the Accounting Division request the department security officer to limit access rights to programmers when it is necessary for their job duties and to log such access to the SBAS data files. The department's security officer began logging access; however, the division and the department's security officer did not review the report reflecting access to the data files.

We agree there are occasions when programmers need access to certain data files; however, such access should be reviewed and approved by the Accounting Division. In addition, such access should be logged and monitored by the division.

Recommendation B7-2b

We recommend the department log and monitor programmer access to SBAS data files.

Response B7-2b

We concur. The Accounting and Management Support Division has implemented a programmer access log review process.

B7-2c.
Application Controls

The Statewide Budgeting and Accounting System (SBAS) is the primary accounting system for state government. The Accounting Division implemented On-line Entry & Edit (OE&E) in February 1989. Using OE&E, agencies input their own SBAS documents instead of sending the documents to Accounting Division for keypunch entry. Some documents are still sent through Accounting Division for keypunch entry. With the change to OE&E, SBAS is a combination of on-line entry (database) and batch update.

During our annual central review, we performed a review of the department's completeness of processing the OE&E database. Accounting Division does not verify that all records approved for processing by the agency on the OE&E database are actually used in update processing. The department does not verify that after processing, all records actually update the database. Another necessary control is for the agencies to compare their SBAS document numbering log to transaction output to ensure that what they intend to enter onto SBAS actually was processed.

Certain controls are particularly important to on-line processing systems. Batching is the process of establishing control totals over data being submitted for processing and comparing the control totals during and after processing to ensure that complete and accurate data are transferred to each processing phase. Agency personnel determined control totals were unnecessary because paper records no longer change hands. It is necessary to ensure information processed by SBAS is complete, or potentially incomplete processing may be undetected.

<u>**Recommendation B7-2c**</u>

We recommend the department establish controls to ensure information submitted through on-line entry and edit to the state's accounting system is processed.

Response B7-2c
We concur. The Accounting and Management Support Division has implemented control procedures to ensure information entered into SBAS is processed.

B7-2d.
OE&E Control Standards

During planning of the SBAS central controls testing, we identified a problem with the audit trail of the agency and user control standards for OE&E. Agency control standards govern standards for the agency as a whole. User control standards govern the functions individual users can perform on SBAS documents. For example, the user control function may establish a user as authorized to approve certain documents. The agency control standards, among other things, establish which documents require approval.

Agencies request the agency and user controls by submitting an OE&E worksheet to the Accounting Division. Accounting Division then enters the controls into the OE&E database. Only Accounting Division personnel can inquire, enter, and change the control standards.

To ensure the agency submitted controls exist, verification that the user controls match the OE&E worksheets submitted by the agencies is necessary. The OE&E system does not have a report listing the user control standards or a function that allows a user to view the user controls. We compared 58 agency request forms to the on-line user controls. Out of the 58 compared, 10 users had incorrect access. One user was authorized by the agency to enter all documents with no approval authority. This user had actual authority to approve transfer warrant claims, collection reports, and journal vouchers.

We also found the OE&E control function does not record the agency user control standards used in the past. Once Accounting Division changes a control standard, the database reflects the new standard. Without the history trail, the information cannot

be traced to the source agency request and changes are not documented for user and agency control standards used in the past.

Recommendation B7-2d

We recommend the department develop a report which documents the agency and user control standards input to the on-line entry and edit system.

Response B7-2d

We concur. The department will develop a report as recommended by July 1, 1990.

B7-3. Unallowable Interest Charges

A prior audit report for the department, covering fiscal years 1983-84 and 1984-85 disclosed an issue regarding interest charges and excessive billings from the department's internal service funds to various federal programs.

As documented in the Statewide Cost Allocation Plan (SWCAP), the department's billing rates for communications, data processing, and publications and graphics cover all costs, including interest, of providing these services to other state agencies. According to Office of Management and Budget, Circular A-87, interest is not an allowable cost for reimbursement from federal grants. Because interest charges are built into the communications, data processing, and publications and graphics rates, state agencies paying these direct charges with federal funds pay for unallowable interest costs.

State law requires internal service operations, such as communications, data processing, and publications and graphics, to charge rates that recover all costs. The department would have to establish dual rates for its internal service funds or bill state

agencies the total amount to recover costs at one rate but document the portion of the bill not allowable to federal programs to ensure compliance with both state and federal law.

It is not feasible to determine the actual liability of the state regarding unallowable interest charges paid by federal programs through these operations' billings due to the large number of rates, agencies, and federal programs involved. The state's liability is the portion of the interest charged to federal funds. The state receives federal funds for the programs listed on the Schedule of Federal Financial Assistance, beginning on page 2 of this report.

Table 3 shows the profit (loss) for the three operations where the interest is included in the total expenses, the adjusted profit (loss) which excludes the unallowable interest, and the net profit (loss) over the four-year period.

Table 3

Internal Service Fund Analysis
Fiscal Years 1985-86 through 1988-89

	Communications	Data Processing	Publications & Graphics
Four-Year Summary			
Charges for Services	$29,988,182	$28,728,028	$16,697,075
Total Expenses	30,594,194	28,706,425	16,159,516
Profit (Loss)	(606,012)	21,603	537,559
Add: Interest Expense	3,958,647	280,308	121,807
Adjusted Profit (Loss)	3,352,635	301,911	659,366
Costs Not Billed (Est. Per SWCAP)	(108,707)	(267,470)	(63,669)
Net Profit (Loss)	$ 3,243,928	$ 34,441	$ 595,697

Source: Compiled by the Office of the Legislative Auditor from the Comprehensive Annual Financial Report and department estimates.

Department personnel indicated they will continue to work with the federal government to achieve compliance with both state and federal law.

The federal government is aware of this issue and is currently preparing a position statement. We make no recommendation regarding the issue, pending federal action.

B8-1.
Federal Grant Activity Classification

During fiscal years 1987-88 and 1988-89, the library recorded activity for the federal subgrants listed below in the State Special Revenue Fund and recorded the related revenue as "Grants, Contracts, Donations and Abandonments." State accounting policy requires the recording of federal subgrant activity in a Federal Special Revenue Fund and the related revenue as "Federal" revenue. State law also requires the recording of federal subgrant activity in the Federal Special Revenue Fund.

Table 4

Federal Subgrant Activity
For Fiscal Years 1987-88 and 1988-89

Grant and Grant Source	Recorded Revenue Amount		Recorded Expenditure Amount	
	FY88	FY89	FY88	FY89
1. Geographical Information System (MT Dept. of Health & Environmental Sciences - Superfund, CFDA #66.802)	$110,674	$200,825	$ 90,574	$218,601
2. Surface Mining (MT Dept. of State Lands - U.S. Office of Surface Mining, CFDA #15.250)	15,000	15,000	24,238	15,000
3. MT Rivers Study (MT Dept. of Fish Wildlife and Parks - Bonneville Power Administration, CFDA #81.999)	8,122	11,725	8,122	15,074
Total	$133,796	$227,550	$122,934	$248,675

Source: Compiled by the Office of the Legislative Auditor.

In addition to the classification problems, library personnel did not analyze recorded revenues and expenditures during the fiscal year-end cut-off periods to determine whether revenue should

be accrued or deferred to match expenditures as required by state accounting policies for federal assistance programs.

These accounting procedures resulted in understated revenues and expenditures in the Federal Special Revenue Fund and overstated revenues and expenditures in the State Special Revenue Fund on the Statewide Budgeting and Accounting System (SBAS). The library overstated total revenues in Table 4 for the first grant by $2,324 and understated total revenues in Table 4 for the second and third grants by $9,238 and $3,349, respectively.

Evidence in the library's files indicated that library personnel contacted the Department of Administration's Accounting Division in March 1989 to determine whether to account for these federal subgrants as federal or state activity. Library personnel had recognized an inconsistent treatment related to their federal subgrants. Some were accounted for in the federal Special Revenue Fund while others, as discussed above, were not. Accounting Division personnel indicated they were researching this issue further and told the library to make no changes until the research was complete. The library should account for federal subgrants in accordance with state law and state accounting policy.

Recommendation B8-1

We recommend the library account for federal subgrant activity in accordance with state law and state accounting policy.

Response B8-1

Concur. The Montana State Library is presenting their budget request for fiscal years 1992 and 1993 classifying these funds as federal special revenue. As these funds were not considered federal in the past, it was not necessary to determine whether

revenue should be accrued or deferred at fiscal year end. This process will be implemented with the change in classification.

Federal Issues
Department of State Lands

B9-1.
Unrecorded General Fund Revenue

State firefighters assist the federal government in fire suppression during the summer months. The state incurs costs that are subject to federal reimbursement. To obtain reimbursement, it is necessary for the Forestry Division to prepare and send a billing statement to the U.S. Forest Service. The agreement between the U.S. Forest Service and the department states the department will bill the U.S. Forest Service on an annual basis. In our prior audit report, we reported the department failed to bill the U.S. Forest Service for $156,009 of fiscal year 1986-87 expenditures until fiscal year 1987-88. This untimely billing resulted in unrecorded General Fund revenue in fiscal year 1986-87.

In fiscal year 1987-88, the department did not accrue Fire Suppression Reimbursement (CFDA #10.999) revenue of $175,894 for fire suppression costs incurred. Instead the department recorded the amounts received for fiscal year 1986-87 and 1987-88 fire suppression reimbursement as a prior year revenue adjustment in fiscal year 1988-89 when it received the reimbursement. State accounting policy states "where expenditures have been recorded but the reimbursement has not been received by fiscal year-end, the amount of the reimbursement should be accrued."

Since the department did not accrue the fire reimbursement revenue, General Fund revenue is understated $175,894 and prior year revenue is understated $156,009 in fiscal year 1987-88. Prior year revenue is overstated $331,903 in fiscal year 1988-89. The department did accrue $1,161,926 of 1988-89 fire suppression reimbursement revenue before fiscal year-end.

Recommendation B9-1

We recommend the department recognize revenue in accordance with state accounting policy.

Response B9-1
Concur. As noted in the findings, the Department properly accrued revenue for FY 89.

B9-2. Compliance with Appropriations Law

The department receives a Fire Suppression Reimbursement (CFDA #10.999) for costs incurred by the state when helping the U.S. Forest Service in suppressing fires on federal land. The department has historically recorded both the expenditures and reimbursements in the General Fund. However, in fiscal year 1988-89, the department recorded $996,450 of the reimbursement in the General Fund and the remaining $165,476 in a federal special revenue fund.

Department officials explained House Bill 100 from the 51st Legislative Session gives the department $100,000 of special revenue fund authority in each fiscal year 1989-90 and fiscal year 1990-91. The funding for the special revenue fund appropriation comes from the fire reimbursement revenue and is intended to allow the department additional expenditure authority for normal forestry operations when its original authority may have been expended in fighting fires. The department deposited part of the reimbursement revenue in the special revenue fund in fiscal year 1988-89 to ensure cash would be available in fiscal year 1989-90 for the expenditures.

We do not believe House Bill 100 authorized the department to use fiscal year 1988-89 General Fund revenue. The provision of HB 100 which authorizes the department to receive and expend up to $100,000 in each year of the 1990-91 biennium does not authorize the use of fiscal year 1988-89 fire reimbursement revenues in the 1990-91 biennium and in fact was not in effect

when the reimbursements in question were earned. Therefore, the department had no authority to withhold the $165,476 of fiscal year 1988-89 General Fund revenue to fund activities in fiscal years 1989-90 or 1990-91. This error results in General Fund revenue being understated $165,476 and federal special revenue fund revenue being overstated $165,476 in fiscal year 1988-89. The department stated funding the appropriation with fiscal year 1989-90 or 1990-91 revenue would be difficult since the department bills the fire reimbursement so late in the year, no cash would be available to fund the expenditures. We believe the department can obtain an inter fund loan to finance the work until the department receives the reimbursement revenue.

Recommendation B9-2

We recommend the department deposit $165,476 of fiscal year 1988-89 fire reimbursement revenue in the General Fund in accordance with state law.

Response B9-2

Concur. The Department believed that the Legislature intended to provide a means to make up lost production because of the 1988 fires. However, the department is unable to verify that contention and, therefore, reluctantly concurs.

B9-3. Abandoned Mine Bureau Internal Controls

The Abandoned Mine Bureau receives 100 percent of its funding from the U.S. Department of Interior Office of Surface Mining Reclamation and Enforcement (CFDA #15.252) to administer Title IV of the federal Surface and Mining Control and Reclamation Act of 1977. The bureau contracts with engineering and construction firms which complete reclamation on abandoned mines which are a threat to public safety. In the Abandoned Mine Bureau one individual was responsible for selecting engineering consultants, approving the engineering contracts, and approving all contract expenditures for payment.

Under a sound internal control system, no one person should be responsible for all of the above mentioned functions.

After discovering problems in the Abandoned Mine Bureau, the department contacted our office for assistance. We reviewed all department invoices and related bureau records between January 1987 and October 1988 processed under a system with inadequate internal controls. We found $32,490 of aircraft rental, per diem and equipment expenditures which provided no apparent benefit to the program. These expenditures appeared to be for personal benefit and not for any state purpose. We also found another instance where the department paid a contractor $23,920 for drilling work performed when the actual drilling cost was $11,960. We were not able to determine what the additional $11,960 payment was for and it provided no apparent benefit to the program or the state. We question the allowability of the $44,450 of grant expenditures. The department has taken steps to resolve the problems by reorganizing the Abandoned Mine Bureau.

We also tested a random sample of Abandoned Mine Bureau grant expenditures for approval by bureau administrative personnel. Approval provides the department with assurance that someone in a management position has reviewed the transaction and ensured it is in compliance with program objectives. Without approval, personnel can make unallowable expenditures with program funds. We found four invoices out of fifty-four items tested in a population of 2,417 transactions where there was no indication administrative personnel had approved them for payment.

In a system where one individual is responsible for selecting contractors, authorizing the contract and approving contract expenditures or where not all expenditures are reviewed and approved, errors or irregularities in the accounting records may go undetected. Because of the nature of the questioned expenditures, we referred our findings to the Attorney General's Office in compliance with section 5-13-304, MCA.

Recommendation B9-3

We recommend the department:

A. Separate the duties of selecting consultants, authorizing contracts, and approving contract expenditures in the Abandoned Mine Bureau.

B. Establish a system to ensure adequate review and approval of Abandoned Mine Bureau expenditures.

Response B9-3

Concur. The Abandoned Mine Reclamation Bureau has modified the contractor selection and payment approval procedures to assure internal control.

B9-4. Office of Surface Mining Project Ranking Reports

The Abandoned Mine Bureau inventories all coal mines and hazardous abandoned mine openings. Bureau personnel then rank these projects according to their environmental, socio-economic, and land utilization impact. The ranking determines how the U.S. Department of Interior's Office of Surface Mining Reclamation and Enforcement (OSMRE) (CFDA #15.252) funds the projects. The department prepares approximately 78 reports each year. We reviewed eight project ranking reports and found three where the department incorrectly calculated the final ranking. Abandoned Mine Bureau personnel manually prepare, then retype the reports prior to their submission to OSMRE. The department does not review the reports for accuracy prior to sending them to OSMRE. Without a review process, errors in the report may go undetected and potentially affect whether or not the U.S. Department of Interior's Office of Surface Mining Reclamation and Enforcement funds a particular project. The errors contained in the reports we reviewed had no effect on whether OSMRE funded the projects.

Recommendation B9-4

We recommend the department develop a review process to ensure the reports submitted to the U.S. Department of Interior's Office of Surface Mining Reclamation and Enforcement are accurate.

Response B9-4

Concur. The Abandoned Mine Reclamation Bureau has developed a procedure to ensure the accuracy of project ranking reports prior to submittal to the Department of Interior, Office of Surface Mining.

Federal Issues
Department of Justice

B10-1. Administrator Appointment

The Highway Traffic Safety Program (CFDA #20.600) is administered by the Highway Traffic Safety Division. The division is headed by an administrator who is responsible for division operations. The Highway Traffic Safety Program was established to enable the state to receive federal funding for highway traffic safety. The original legislation, Chapter 177, Laws of 1967, provided for a Highway Traffic Safety Board appointed by the governor and responsible, among other things, for hiring of necessary personnel to carry out the intent of the Highway Traffic Safety Act.

During recodification in 1974, Chapter 348, Laws of 1974, repealed legislation relating to the Highway Traffic Safety Board thereby abolishing the board. No provisions were made for the appointment authority of the division administrator.

Section 2-15-2007, MCA, provides that Highway Traffic Safety Division is administratively attached to the Department of Justice but the program may hire its own personnel. Section 61-2-103, MCA, provides that the governor is responsible for the administration of the program. Since both state and federal regulations require the governor be responsible for the administration of the Highway Traffic Safety Program, it appears the governor should be the appointing authority for the administrator of the Highway Traffic Safety Division. We recommended in our last audit report that the governor seek legislation to clarify appointment authority for the division administrator. The legislation was not requested.

<u>Recommendation B10-1</u>

We recommend legislation be enacted to clarify the appointment authority for the Highway Traffic Safety Division administrator.

Response B10-1
Legislation, if appropriate, should be prepared and submitted by either the Governor's Office or the Office of the Legislative Auditor.

B10-2.
Indirect Cost Reimbursement

We recommended in our three prior audits the Crime Control Division prepare an indirect cost proposal and recover indirect costs of federally supported programs. State policy requires agencies prepare an indirect cost proposal to claim indirect costs for both agency and statewide allocated indirect costs. Section 17-3-111, MCA, states in part, "grantee agencies shall, in accordance with federal regulations and guidelines, negotiate indirect costs rates and endeavor, to the fullest extent possible, to recover indirect costs of federal assistance programs."

Indirect costs include both the overhead costs originating in an agency performing a grant or contract and the costs of central government services distributed through the statewide cost allocation plan (SWCAP) and not otherwise treated as direct costs. In fiscal year 1987-88 and fiscal year 1988-89, $9,989 and $11,662, respectively, were allocated to the division for SWCAP costs. A portion of these costs may be recoverable if an indirect cost proposal has been prepared and negotiated with the federal government. The potential for indirect cost recovery may, however, be limited by grant provisions.

In our last audit a division spokesman responded that the three large block grants; Juvenile Justice (CFDA #16.540), Criminal Justice (CFDA #16.573), and Victim's Assistance (CFDA #16.575), placed limits on administrative cost claims. Division personnel indicated the maximum allowable amount of administrative cost was already being charged to these programs as direct charges. The division believed it was not cost effective to prepare an indirect cost proposal since the grants placed limits on or allowed no administrative cost recovery. Although the division did not believe it would be cost effective, the division indicated it would prepare an indirect cost proposal to comply with state policy. Our follow up during the current audit

revealed no indirect cost recovery plan has been prepared. Division personnel indicated changes in administrators and employee turnover delayed preparation. At a minimum the division should negotiate to recover SWCAP indirect costs and seek recovery for the indirect costs before charging direct costs. The negotiation of including SWCAP costs where allowable should result in insignificant costs to the division.

Recommendation B10-2

We recommend the Crime Control Division recover all allowable indirect costs of administering federal programs.

Response B10-2

We will prepare an indirect cost plan and submit it to our cognizant federal agency for approval.

Our agency administers federal grant programs that provide aid to the criminal justice system or crime victims. Some of the block grants do not permit administrative costs. The grants that do permit administrative costs restrict them to percentages that range from 2% to 10% of the block grant award. For the majority of the grants we administer, we recover the maximum administrative costs allowable and no additional funds will be recovered as a result of preparing and negotiating an indirect cost plan. For those grants in which the maximum administrative costs were not recovered, the funds were passed through the state and local governments in the form of sub-grants and were still of benefit of Montana.

B11-1.
Internal Controls

The department's responsibilities include establishing and maintaining adequate systems of internal controls. The objectives of a system of internal control are to provide management with reasonable, but not absolute, assurance that resource use is consistent with laws, regulations, and policies; resources are safeguarded; and reliable data is obtained, maintained, and disclosed in management reports. Because of inherent limitations in any system of internal control, errors or irregularities may occur and not be detected. However, a good system of internal control reduces the risk of such errors or irregularities.

During our audit we noted weaknesses in the department's control systems over completeness of accounting records, data base reconciliation, support for transactions, property, plant and equipment, payroll, and management controls. With the exception of the MVS resident account system, the control weaknesses noted also affect controls over the department's federal funds. The department receives 80 percent of its federal funding from the U.S. Department of Health and Human Services. The majority of this funding relates to the aging program. The remainder of federal funding received by the department is from the U.S. Department of Agriculture and the U.S. Department of Justice. The significant weaknesses we noted and suggestions for strengthening controls are discussed in the following report sections.

B11-1a.
Completeness of Accounting Records

The department is responsible for ensuring the completeness and accuracy of its accounting records. During fiscal year 1988-89, the department recorded approximately 72,000 transactions on the Statewide Budgeting and Accounting System (SBAS). The Department of Administration, Accounting Division, provides agencies with a daily report of all transactions recorded on the accounting records. State accounting policy states, ". . . the SBAS daily transaction report should be reconciled with the agency document numbering log. This review should be performed daily and should be documented by a signature and date

on the document log." We noted the department does not use the daily report or follow the state policy. As a result, the department does not have a system to ensure all transactions are input, processed, and recorded correctly on SBAS. In addition, it does not ensure all transactions which were recorded on SBAS represent financial activity of the department. Since the department allows the Department of Social and Rehabilitation Services to input daycare payments, authorized by department field employees, on its accounting records, the importance of this review is increased. If the department complied with this policy, it could help ensure all transactions were input, processed correctly, and represented financial activity of the department.

Department personnel stated they rely on controls at the Accounting Division to ensure documents are properly processed. However, Accounting Division does not provide assurance that all transactions were authorized by the department, were received by the Accounting Division for input or were recorded as intended. Since the department is responsible for all information recorded on its accounting records, it should perform a review to ensure information recorded is authorized, accurate, and complete.

Recommendation B11-1a

We recommend the department review the daily transaction listing to ensure information recorded on SBAS is authorized, accurate, and complete.

Response B11-1a

We concur with the recommendation. By July 1, 1990, the Department will implement procedures to use the daily transaction listings to verify the information recorded in SBAS.

B11-1b.
Data Base Reconciliation

The department administers the foster care program (CFDA #13.645, 13.652, and 13.658). It uses a data base developed and maintained by the Department of Social and Rehabilitation Services to summarize services provided and payments made on behalf of foster care children. The department recorded on the data base approximately $9 to $9.6 million of foster care benefits paid each fiscal year during the audit period. It updates SBAS weekly for financial activity recorded on the data base. During fiscal years 1987-88 and 1988-89, the department reconciled the data base to SBAS twice. One reconciliation was performed as of the end of February 1988 and the other was performed as of the end of May 1989.

We noted the amounts recorded on the data base did not agree to the amounts recorded on SBAS by $457,974 and $829,974 at fiscal year-end 1987-88 and 1988-89, respectively. According to department personnel, the differences at fiscal year-end were largely due to the timing of when activity is recorded on each system and the recording of accruals. Since the department did not perform a reconciliation at each fiscal year-end, it could not support the actual differences. State accounting policy requires agencies to implement internal control procedures to ensure all transactions necessary for compliance with Generally Accepted Accounting Principles (GAAP) are recorded on SBAS before fiscal year-end. Therefore, the department should reconcile SBAS to the data base at each fiscal year-end to ensure information recorded on SBAS is complete and accurate.

Recommendation B11-1b

We recommend the department reconcile SBAS and the data base at fiscal year-end to ensure the accuracy and completeness of the state's accounting records.

Response B11-1b

We concur with the recommendation. As mentioned in the report, the main problem with providing a total reconciliation between the data base system and SBAS is the timing differences in when and how the information is recorded on each system. As an example, Fiscal Year 1989-1990 year-end reconciliation was completed using October 1989 data base information. To help ensure the accuracy of the fiscal year-end SBAS information, the Department will establish procedures to provide an interim reconciliation for fiscal year-end and a final reconciliation in a timely manner after the year-end activity is recorded in data base.

B11-1c.
Support for Transactions

During our testing, we noted several instances where SBAS documents lacked sufficient supporting documentation to adequately explain the basis for transactions recorded on SBAS. These transactions, which totalled approximately $1.3 million, are described as follows.

- The department could not provide support to demonstrate lodging, meal, and phone charges on 6 out of 43 employee travel vouchers tested, as discussed in section B11-2d, were within applicable state travel laws.

- The department could not provide support for numerous journal vouchers. It used these vouchers to correct errors on the accounting records. In addition, we noted the department does not have a system to reference the original document to the subsequent correcting document. Therefore, the department can not efficiently determine if errors on documents were corrected.

- The department's support on various documents did not mathematically agree to amounts entered on the accounting records.

Department personnel could not explain many of the accounting transactions which were not supported. In order to explain other accounting transactions, department personnel spent a substantial amount of time recreating support documentation. If the personnel should terminate employment at the department,

new personnel would not be able to explain accounting transactions because the documents do not have support attached.

Every SBAS document should be properly and adequately supported in order to determine the reasonableness and accuracy of the transaction. Without sufficient support documentation, the possibility exists that invalid or incorrect transactions are reported on SBAS.

Recommendation B11-1c

We recommend the department establish procedures to ensure adequate written support documentation exists for all accounting transactions processed.

Response B11-1c
We concur with the recommendation. The Department agrees that adequate and complete documentation must be available to support all accounting activity. We have implemented procedures to ensure that the support documentation will be attached to all transactions.

**B11-1d.
Property, Plant and Equipment**

The state maintains a Property Accountability Management System (PAMS). This system is used by agencies to manage and account for fixed assets. According to state policy, the department should record equipment with a unit cost of $1,000 or more on PAMS. In addition, state policy requires the department assign each equipment item a property number and a corresponding property tag. Federal regulations require the department to comply with the established state standards when recording equipment purchased with federal funds.

During our audit, we noted the department does not follow state policy nor does it have a system to account for or safeguard its

equipment. We noted the following three specific concerns related to management of equipment by the department.

- The department's central office recorded 198 equipment items transferred from the Department of Social and Rehabilitation Services (SRS) on PAMS, as one property number. The equipment items totalled approximately $142,000.

- The department's central office did not record on PAMS approximately $82,162 and $86,515 of equipment purchases during fiscal year 1987-88 and 1988-89, respectively. Also, it has not recorded deletions for equipment disposed of during the two years.

- The department's central office has not affixed property tags to equipment transferred from SRS or purchased during fiscal years 1987-88 and 1988-89.

According to department personnel, they believed PAMS was automatically updated any time a purchase was coded as an equipment expenditure on SBAS. The department must analyze and decide which items shown on the monthly SBAS listing of equipment expenditures provided by the Department of Administration, Accounting Division, require recording on PAMS. The department then needs to process a transaction to record the equipment on PAMS. The department should establish control procedures to ensure all equipment belonging to the state is tagged for identification and properly recorded on the state's accounting records.

Recommendation B11-1d

We recommend the department establish control procedures to ensure all department equipment is tagged for identification and properly recorded on the state's accounting records.

Response B11-1d

We concur with the recommendation. With the staff available, the property control function has had a lower priority than other administrative functions. The Department will implement procedures to identify equipment items, assign property numbers, tag appropriate equipment and update the PAMS system. It is expected that this can be completed by January 1, 1991.

B11-1e. Payroll

The department's budgeted personal service expenditures were approximately $13 million a year in fiscal years 1987-88 and 1988-89. During our audit, we noted the department's central office does not ensure all time sheets are signed by the employee and approved by the employee's supervisor prior to processing. According to department personnel, they allow employees from the eastern portion of Montana to submit time sheets to the department's central office at the end of the pay period without supervisory approval so the payroll can be processed timely. They further indicated the supervisor approves and submits a time sheet for each employee after the end of the pay period.

We noted the department does not ensure the approved time sheets are received. It also does not compare the approved time sheet to the original time sheet to ensure the hours the employee was paid for were correct. Since a supervisor's approval on the time sheet certifies that the employee actually worked the hours claimed, the department should ensure that paid hours agree to time sheets approved by an employee's supervisor.

We also noted Mountain View School (MVS) does not have an adequate segregation of duties over payroll processing. One employee is responsible for preparing payroll changes, preparing the prepayroll, and distributing the payroll warrants to employees. Even though this employee does not approve the payroll changes and prepayroll, he/she receives these documents back after they are approved and prior to delivery to the State Auditor's Office for processing. As a result, the potential exists for a preparer to alter the prepayroll after approval and to

distribute warrants containing altered or fictitious payroll information. Adequate segregation of duties is important so an employee is not assigned duties that would allow that employee to commit and conceal errors.

Recommendation B11-1e

We recommend the department:

A. Establish procedures to ensure employees' pay is based on time sheets approved by the employee's supervisor.

B. Adequately segregate duties of personnel responsible for processing payroll.

Response B11-1e

A. We concur with the recommendation. Due to the large number and varied locations of our field staff and supervisors, it has not always been possible to receive a timesheet for each employee prior to the payroll submission deadline. Since the implementation of the on-line entry system for payroll, the receiving of approved timesheets has become less of a problem. If it is still necessary to use a copy of a timesheet for payroll submission, Department procedures require that the approved timesheet be compared with and attached to the copy to ensure that the employee's payroll was correct.

B. We concur with the recommendation. Mountain View has two positions in the business department, a business manager and a payroll tech. We have established written criteria that currently meets the recommendations made in this audit.

B11-2.
State Compliance

We reviewed selected state laws and regulations pertaining to the department. Federal regulations require the department expend federal funds in compliance with state laws. If the department does not comply with state laws, it could affect the allowability of expenditures for federal reimbursement. The cash management and expenditure recording procedures, operating budget, accounting records, travel, administrative cost recovery, and telephone policy sections discussed below affect federal programs the department administers. The department receives its federal funding from departments noted in section B11-1.

B11-2a.
Cash Management and Expenditure Recording Procedures

The department receives moneys from state, federal, and county governments to fund its programs. Many of the programs it administers are funded by a combination of these sources. At the beginning of each fiscal year, the department establishes a percentage of funding by source on SBAS. When expenditures are recorded on SBAS, the designated sources are charged. During our audit, we noted the department does not initially record the expenditures to the funding source in the percentage each government entity participates.

During fiscal year 1987-88 and 1988-89, we noted the department initially recorded approximately $2 million and $3 million of expenditures, respectively, in the General Fund. The department abated the expenditures from the General Fund and recorded them in the Special Revenue Fund during the May through the fiscal year-end period. As a result, the department used state General Funds to temporarily fund expenditures which were the responsibility of the federal or county governments. Section 17-2-108, MCA, states, "The department shall apply expenditures against non-General Fund money whenever possible before using the General Fund appropriations."

According to department personnel, they recorded the expenditures in the General Fund because of delays in receiving moneys from federal and county governments. State agencies are allowed, under certain circumstances, to obtain inter-entity

loans to alleviate temporary cash flow problems. Appropriate use of these loans would allow the department to record the expenditures in the proper fund.

In addition, the department receives the majority of its funds from the U.S. Department of Health and Human Services using a letter of credit. Under the letter of credit agreement, the department may draw funds as the grant costs are incurred. We noted the department, during fiscal year 1987-88, did not request significant federal funds until April 1988. During the months of April and June 1988 the department requested federal funds totalling approximately $5 million. For fiscal year 1988-89, the department requested draws approximately once a month starting in October 1988. These draws ranged from $100,000 to $1.1 million per month. The department should initially record allowable expenditures in the Special Revenue Fund and establish procedures to draw federal funds more frequently.

Department personnel stated they do not know the exact participation percentages for the various funding sources at the start of each fiscal year. However, the federal percentage is based on notification of the Federal Participation Rate at the beginning of each federal fiscal year. In addition, section 41-3-1122, MCA, limits the level of county expenditures for each fiscal year. The department should monitor expenditures and participation agreements throughout the fiscal year and change, if required, the participation percentages as soon as information is available.

Department personnel further stated they recorded the expenditures in the fund where appropriation authority was available. Section 17-7-402, MCA, allows for budget amendments provided specific criteria is met. If federal and county government funding is greater than anticipated, the department should request a budget amendment decreasing its General Fund appropriation and increasing its Special Revenue Fund appropriations. It could then record the expenditures in the proper fund.

In order to allow for proper recording of initial expenditures and alleviate the need for department personnel to record expenditures in the wrong fund, the department should:

1. Establish cash management procedures to draw federal funds as grant costs are incurred.

2. Obtain and use inter-entity loans when a delay in reimbursement occurs.

Recommendation B11-2a

We recommend the department:

A. Establish cash management procedures to allow proper recording of expenditures.

B. Request federal funds on a timely basis.

Response B11-2a

A. We concur with the recommendation. While it is true that we are aware of the federal participation percentages for the various funding sources at the start of each fiscal year, we are not aware of the exact amounts we may collect from each source. The exact sources for the majority of federal funds recovered are determined quarterly by a random-moment time study process (RMTS). The RMTS provides a percentage rate by which the Department distributes its field staff administrative costs to individual federal programs. This percentage rate changes quarterly depending on how the field staff activities are compiled by the RMTS. Because of this process, it is not possible to establish an "exact" rate for federal funds available for department administrative costs. To adapt to this in a simple and efficient manner, we have tried to implement a process by which we periodically review our actual collections of non-state funds and adjust the expenditures on SBAS to reflect the collections. This was not always done in a timely

manner during the audit period, which resulted in some expenditures being charged to the wrong funds for a period of time. Adjustments were made by fiscal year-end to match, in total, the federal funds available and the SBAS expenditures. The Department will review its current procedures and implement, for fiscal year 1991, new procedures to ensure that expenditures will be made to the proper funds on a timely basis which would limit the number of funding adjustments that would have to be made during the year.

B. We concur with the recommendation. The problems encountered with receiving federal funds during fiscal year 1988 were the result of starting up a new agency. These problems were resolved by the end of fiscal year 1988. Currently, we are drawing field funds on a current basis and, for fiscal year 1991, we will establish written guidelines by which we will request funds.

B11-2b.
Operating Budget

According to House Bill 2, Laws of 1987, "Expenditures by a state agency must be made in substantial compliance with an operating budget approved by an approving authority." For the executive branch agencies, the governor or his designated representative is the approving authority. House Bill 2 defines substantial compliance as no expenditure category in an approved budget being overspent by more than 5 percent.

Due to changes in the method in which area agencies earn federal funds and in order to spend within its Special Revenue Fund operating budget, the department abated $598,678 of fiscal year 1988-89 aging program expenditures and recorded the expenditures in fiscal year 1989-90. As a result of charging the expenditures to the incorrect fiscal year, the department's accounting records do not accurately reflect the costs of the aging program (CFDA #13.633, 13.635, and 13.668). In addition, had the department charged the expenditures to the correct fiscal year, it would have overspent its fiscal year 1988-89 aging program operating budget by $406,330, or 6 percent.

The department should monitor its spending throughout the fiscal year to identify, as soon as possible, potential budget shortfalls. The sooner the department identifies shortfalls, the easier it is to implement possible solutions. House Bill 2, Laws of 1987, allows the department to amend its operating budgets. Since the department had appropriation authority available in other operating budgets within the same appropriation, it should have requested an operating budget amendment. It could then have charged the expenditures to the proper fiscal year.

Recommendation B11-2b

We recommend the department establish procedures to ensure expenditures do not exceed the approved operating budgets.

Response B11-2b
We concur with the recommendation. Due to a change in federal regulations, the area agencies on aging were allowed to earn federal funds faster than they had previously. This meant that during fiscal year 1989 they earned federal funds that were actually budgeted in fiscal year 1990. As federal regulations allowed this and the area agencies had already spent the funds, the Department reimbursed them and recorded it as an advance during Fiscal Year 1989. To avoid this situation in Fiscal Year 1990 and future years, we are working with the Office of Budget and Program Planning to obtain a supplemental appropriation for this year. This will be completed by June 30, 1990.

B11-2c.
Accounting Records

Financial information of the department is used by department officials, budget analysts, and the legislature to manage and establish funding levels for the department. Section 17-1-102(4), MCA, indicates "all state agencies . . . shall input all necessary transactions to the accounting system . . . before the

accounts are closed at the end of the fiscal year in order to present the receipt, use, and disposition of all money and property for which the agency is accountable in accordance with generally accepted accounting principles." The Department of Administration, Accounting Division, establishes state accounting policies for agencies to follow to ensure information recorded on the state's accounting records complies with GAAP. During our audit, we noted the following instances where the department did not comply with state laws and state accounting policies.

- State accounting policy establishes expenditure classifications which identify the nature of the amounts disbursed. The department should properly and consistently use the expenditure classifications to ensure the accuracy and usefulness of information on the accounting records. We noted several instances in which the department did not use the proper expenditure classification. For example, the department classified $4,523,237 and $5,107,118 of contracts with area agencies in fiscal years 1987-88 and 1988-89, respectively, as aging benefit and claims (CFDA #13.633, 13.635, and 13.668). These expenditures should be classified as grants since the payment is not made directly to an individual.

- The department contracts with another state agency for the storage, handling, ordering, and delivery of USDA food commodities (CFDA #10.550). This activity, amounting to $51,125 and $52,980 for fiscal year 1987-88 and 1988-89, respectively, was inappropriately classified as rent rather than contracted services.

- During fiscal year 1987-88, the department charged approximately $15,000 of travel expenses to Child Abuse and Neglect benefits and claims (CFDA #13.669).

- During fiscal year 1987-88, the department did not establish revenue accruals for foster care benefits and administrative costs incurred by the department which were subsequently recovered through county billings. Because this revenue was earned in fiscal year 1987-88 and the amount could be reasonably estimated, state accounting policy requires the department to accrue it at fiscal year-end. As a result of this error, revenue was understated during fiscal year 1987-88 by approximately $305,000.

- We tested approximately $1 million of the $2 to $2.5 million of revenue accruals the department established for each fiscal year. Department personnel were unable to provide us with adequate information to determine how these revenue accruals were computed. Since the department, does not have procedures to follow in estimating revenue accruals, we were unable to determine if the accruals were reasonable.

- State accounting policy requires agencies to accrue expenditures if a valid obligation exists at fiscal year-end. We noted the department has not established procedures to ensure valid obligations which exist at fiscal year-end are recorded on SBAS. For example, we noted an agreement the department had entered into as of May 1989 in which the department agreed to pay $55,000 for services provided during fiscal years 1987-88 and 1988-89. Since a valid obligation existed as of fiscal year-end, the department should have accrued this expenditure on the state's accounting records.

- State accounting policy requires Mountain View School (MVS) and Pine Hills School (PHS) to update SBAS at the end of a fiscal year to reflect the balance of the resident accounts. We determined PHS did not include saving accounts totalling $18,851 in its fiscal year 1987-88 SBAS balance. MVS did not update SBAS to agree with its subsystem, which resulted in an understatement on SBAS of $1,191 at fiscal year-end 1988-89. In addition, MVS did not update SBAS for approximately $710 of interest earned during fiscal years 1987-88 and 1988-89 on the resident accounts.

- State accounting policy requires departments to use agency funds to account for moneys held by the state in a trustee capacity. MVS recorded approximately $3,000 of revenues and expenditures related to its recreation moneys in an Agency Fund rather than a Special Revenue Fund. As mentioned in our prior audit, these moneys do not meet the criteria of an Agency Fund.

- As of July 1, 1987, MVS and PHS were required to account for all financial activity under the Department of Family Services' agency number. At June 30, 1989, we noted MVS and PHS still had asset balances of $124,943, $36,690, and $33,755 recorded under the old agency numbers in the

General, Special Revenue, and Agency Funds, respectively. In addition, MVS and PHS had liability balances of $10,405 and $27,854 recorded under the old agency numbers in the Special Revenue and Agency Funds, respectively.

- State accounting policy requires agencies to record fixed assets at original cost. If the original cost information is not available, agencies may estimate the original cost of such assets. We noted in this, and the previous two audits, PHS revalued the cost of land on SBAS. Since this revaluation is not in accordance with state accounting policy, we estimated land is overstated by $58,000 at fiscal year-end 1988-89.

Without all financial activity properly recorded on SBAS, the quality, consistency, and comparability of the resulting financial information is affected. Many of these errors resulted from employees' unfamiliarity with state accounting policies, failure to follow state policies, inadequate reviews of accounting documents by authorized individuals, and human error. The department should establish procedures to ensure proper recording of transactions on the state's accounting records. Procedures should include, but are not limited to:

1. Coding expenditures in accordance with state accounting policy.

2. Recording revenue and expenditure accruals at fiscal year-end.

3. Updating SBAS to reflect the balance of residence accounts and land at fiscal year-end.

4. Recording recreation activity in the Special Revenue Fund.

5. Providing training to its personnel.

6. Adequately supervising and reviewing the work of department personnel to ensure errors are minimized and detected in a timely manner.

Recommendation B11-2c

We recommend the department establish procedures to ensure the financial activity on SBAS is in accordance with state laws and state accounting policy.

Response B11-2c
We concur with the recommendation. Many of the errors in expenditures classification were the result of inherent start-up problems and staff turnover during the audit period. To ensure the consistency and reliability of its SBAS information, the Department will prepare written procedures for classifying expenditures for all programs and operations. The procedures will also address the methods to be used for preparing revenue and expenditure accruals.

The Department was not aware that the classifying of the payments to the area agencies as benefits and claims was not proper. This was the procedure that had been used for many years and was the classification used for the biennium budget request. We are currently working with the Governor's Office of Budget and Program Planning to make the proper adjustments for both the current biennium and the new biennium request.

As part of the new internal controls and monthly reconciliation of the custodian cash account at MVS, the SBAS updates will occur monthly, and interest earned by the account will be allocated monthly when the new resident-accounting subsystem programming is fully completed. All non-custodian cash activities are currently being recorded in the State Special Revenue Fund. All MVS and PHS financial activity will be recorded in SBAS under the Department of Family Services by Fiscal 1990 end.

PHS will review the cost information available for their fixed assets and, by fiscal year-end, adjust the amount on SBAS to be in accordance with state accounting policy.

B11-2d.
Travel

The department processes a high volume of travel vouchers submitted by department personnel. During each of fiscal years 1987-88 and 1988-89, the department recorded approximately $600,000 of travel expenses on the accounting records. We reviewed a sample of 43 travel expense vouchers processed by the department during the audit period and noted six instances where reimbursement for meals, lodging, and mileage were not in compliance with state per diem laws. For example, one employee was reimbursed at $37.39 per night and another reimbursed at $28.08 per night for lodging when state law only allows $24.96 per night. We noted another employee was reimbursed $112 for three days of meals when state law allows $14.50 per day. We also noted the department reimbursed an employee 20.5 cents per mile rather than the allowed rate of 22.5 cents per mile for personal vehicle use. We further noted an instance where the department paid for a meal when the employee was not in travel status as defined by state policy. Sections 2-18-501, 2-18-502, and 2-18-503, MCA, provide specific meal and lodging reimbursement rates, the time period an employee must be in a travel status to be eligible for specific meals, and mileage limits which may be claimed. In addition, federal regulations require the department to follow established state laws. Since the instances noted above were reimbursed with federal funds, we question $130 of costs for the Aging Grant (CFDA #13.633).

The majority of the travel expense vouchers are approved by the employee's supervisor and submitted to the central office for payment. The supervisor's signature on these claims verifies that the employee traveled and should be reimbursed. According to department personnel, the central office completes a limited review of travel expense vouchers because of the large number of vouchers submitted monthly. Department personnel believed the extra work involved in completing a more thorough review of vouchers would not be cost beneficial.

The department should establish adequate policies and procedures to ensure travel rates paid to employees are in accordance with state law. Since the field supervisor is required to approve employee travel vouchers, the department could provide the supervisors with documentation of allowable reimbursement rates to require them to review the travel expense vouchers before approving the voucher. This would limit the extent of review required at the central office.

Recommendation B11-2d

We recommend the department establish policies and procedures to ensure travel reimbursements are in accordance with state laws.

Response B11-2d

We concur with the recommendation. As mentioned in the report, most of the travel vouchers are approved by field staff supervisors. To improve this review and approval process, the Department will: (1) provide all staff with current state policies on travel reimbursement; (2) provide staff with written Department procedures and policies for review and approval of travel vouchers; and (3) include training on travel policies at future supervisor training sessions. Written travel review procedures and policies will be completed by June 30, 1990.

B11-2e. Administrative Cost Recovery

Federal regulations allow state agencies reimbursement for indirect costs necessary for the administration of federal grants. Section 17-3-111, MCA, requires state agencies to recover indirect costs of administering federal assistance programs to the fullest extent possible. Recovery of indirect costs reduces the amount of state money required to support federal programs.

The department's central office, Mountain View School (MVS), and Pine Hills School (PHS), each negotiate a separate indirect

cost rate to recover indirect costs. The department's central office calculates its indirect cost rate by determining the percentage of total indirect costs to personal service expenditures. We noted the department's central office excluded MVS and PHS expenditures in its total indirect cost base. However, the department included MVS and PHS personal service expenditures in its personal service base. Since MVS and PHS did not include its percentage of related central office indirect costs when negotiating its indirect cost rate, MVS and PHS did not recover indirect costs to the fullest extent possible, in accordance with state law. In the future, the department could:

1. Require MVS and PHS to include its percentage of related central office indirect costs when negotiating its indirect cost rate, or

2. Include all MVS and PHS indirect costs in its indirect cost base and negotiate one indirect cost rate for the department as a whole.

Recommendation B11-2e

We recommend the department recover indirect costs to the fullest extent possible in accordance with state law.

Response B11-2e

We concur with the recommendation. Future indirect cost proposals for MVS and PHS will include their respective share of central office indirect costs as determined by the current indirect cost plan. This should ensure that all eligible department indirect costs are charged to federal programs.

B11-2f.
Telephone Policy

State policies establish guidelines for personal use of the state telephone system. These policies allow essential personal calls with certain restrictions. The policies state long distance personal calls must be either collect, charged to a third party non-state number, or charged to a personal credit card. The policies

further state each agency is responsible for enforcing policies related to the use of the state's telephone.

During our audit, we noted the department is not adhering to state policies. Contrary to state policy, the department allows staff to make personal long distance calls on the state telephone system by charging the call to the department and later reimbursing the department for the call. During our review of travel expense vouchers, we noted three instances where the department reimbursed employees for long distance calls without adequate support indicating the call was business related. The department should establish and enforce a policy addressing employee use of the state telephone system.

Recommendation B11-2f

We recommend the department implement and enforce state policy concerning employee use of the state telephone system.

Response B11-2f

We concur with the recommendation. We have previously circulated state policy on telephone use to Department employees, but we have not formally adopted Department policy or procedures regarding telephone usage and administrative review of telephone usage. This will be done by September 30, 1990.

B11-3. Federal Financial Reports

The federal government requires state agencies to periodically report the financial status of grants received by the state. Federal regulations require the recipient of the grants to ensure the financial status reports contain reliable financial data. During our review of the federal fiscal year 1987-88 aging report (CFDA #13.633, 13.635, and 13.668) submitted by the

department, we noted the expenditures reported did not agree to SBAS. The following is a schedule of differences noted in the amounts reported for the federal share of expenditures.

Aging Grants	Federal Report	SBAS	Difference
Title IIIB	$1,162,598	$1,281,155	$(118,557)
Title IIIC1	1,312,297	1,620,090	(307,793)
Title IIIC2	538,665	392,968	145,697
Title IIID	22,751	22,493	258

Department personnel were unable to account for the differences. Since federal regulations require financial reports submitted be complete and accurate and SBAS has been designated as the state's accounting system, the department should ensure the amounts reported to the federal government are reconciled to SBAS.

Recommendation B11-3

We recommend the department ensure amounts reported on the federal financial reports reconcile to the accounting records.

Response B11-3

We concur with the recommendation. The Aging Services Bureau is responsible to prepare accurate financial reports to the Administration of Aging quarterly. These reports are based upon various reports received from the 11 Area Agencies on Aging across the state and show the actual expenditures of the Area Agencies on Aging and not the amount recorded on SBAS as being sent to the Area Agencies. Because the guidelines from the federal agency emphasize the need for reports to be sent in on time and that an estimate of expenditures can be used until better data is available, some quarterly reports may include estimates of Area Agency expenditures. Final federal fiscal year reports (ending September 30) are adjusted to reflect actual

expenditures that were estimated in previous quarterly reports. The final federal fiscal year-end reports from the Area Agencies will be reconciled to SBAS to ensure that the federal reports and SBAS information is accurate.

B11-4. Management Controls

Primary functions of management include organizing, directing, and controlling the activities of an entity in order to accomplish the objectives of the entity. The methods management adopts to carry out these functions constitute the management control system. The previous report sections discuss areas where management could improve its direction and control of staff activities. For example, the department did not ensure activity recorded on the accounting records was complete and accurate and it did not comply with various state and federal laws and policies. As a result, we issued a qualified opinion on the department's financial schedules. The problems identified affect the department's federal financial assistance from the U.S. Department of Health and Human Services, U.S. Department of Agriculture, and U.S. Department of Justice.

When the department was created by the 50th Legislature, start up problems were inherent. Some of the problems we noted can be attributed to the newness of the department. However, many of the problems we noted occurred because department personnel did not have adequate training regarding laws and accounting policies. In addition, key accounting personnel did not provide adequate supervision and guidance to employees and did not thoroughly review transactions recorded on the state's accounting records.

The recommendations made in the previous report sections would, if implemented, improve department operations. In addition to these recommendations, we noted a need for increased awareness and knowledge by management in order to ensure management controls are adequate. Some additional steps management should consider taking to further improve operations include:

1. Providing additional training to its employees.

2. Providing more supervision and review of its employee's work.

The department should consider all aspects of its operations when evaluating and revising procedures.

Recommendation B11-4

We recommend the department:

A. Provide training to personnel at all levels to enhance compliance with state and federal laws and policies.

B. Adequately supervise and review department personnel's work to ensure errors are minimized and detected in a timely manner.

Response B11-4
We concur with the recommendation. As mentioned in previous agency responses to recommendations, the Department will be developing more written policies and procedures regarding its administrative operations. We feel that the implementation of these policies and procedures will do much to increase both the efficiency of department operations and the accuracy of its financial activity. To enhance the level of expertise for our employees, the department will also participate, as much as possible, in both state and federal sponsored training sessions.

Federal Issues - Department of Social and Rehabilitation Services

B12-1. Medicaid Reimbursement for Certain Institutions

The Montana Developmental Center (MDC) and Eastmont Human Services Center (EHSC) receive reimbursements under the Medicaid (CFDA #13.714) program as intermediate care facilities for the mentally retarded (ICF-MR). Facilities providing ICF-MR care are eligible to receive Medicaid per diem payments at a cost-based rate. The above two institutions did not recover the full amount of reimbursement allowed by the federal government because SRS limited rate increases to nine percent a year through the administrative rule process. The nine percent limit on ICF-MR rate increases was established to save General Fund money by restricting the state and federal share to a nine percent increase. However, when the limit was established, SRS did not consider the effect on state institutions which are funded primarily with General Fund money. As a result of SRS policy, the state lost federal reimbursements for an estimated $1,079,000 in allowable ICF-MR costs over the past three fiscal years.

Federal regulations only require that the match be met with funds received from other than federal sources. If the state or another provider can furnish matching funds for ICF-MR services, SRS rules should allow disbursing federal funds to the provider to cover full allowable costs. We determined that sufficient General Fund expenditure effort occurred at both MDC and EHSC to match federal funds for all allowable per diem costs.

The department disburses Medicaid reimbursements to the institutions based on interim rates established in the Administrative Rules of Montana (ARM). The interim payment rates are based on estimates. Actual payment rates are not final until desk reviews and settlements are completed. The rates have not been finalized for the fiscal years 1986-87, 1987-88, and 1988-89. Section 46.12.1204 ARM provides procedures for adjusting

the interim payment rate. Because final settlement for these years has not occurred, it may be possible to implement regulations to enable the state to recover the $1,079,000 of allowable costs noted above.

We believe SRS may initiate changes to the ARM and the Medicaid state plan to ensure that MDC and Eastmont receive reimbursements based on their costs. The department can propose changes to the ARM and the Medicaid plan which allow for the disbursement of the federal Medicaid matching funds if the ICF-MR provider can provide matching funds from nonfederal sources. Since the current state Medicaid plan refers to the ARM section on payment rates, SRS must also submit the new regulation to the federal Health Care Financing Agency (HCFA) as an amendment to the state Medicaid plan. The effective date of any proposed rule changes should be contingent upon final approval of the Medicaid amendment by federal officials.

Department management indicated SRS will propose changes in the ARM and state plan to ensure maximum reimbursement during current and future periods. A department official indicated HCFA has approved the department's request to use fiscal year 1988-89 as a base year for costs. This change could enable the state to recover $715,000 in costs incurred at MDC in fiscal year 1988-89. In addition to the potential recovery of the $1,079,000 discussed above, we estimate these changes may enable the state to recover $826,000 for the General Fund in fiscal year 1989-90.

<u>Recommendation B12-1</u>

We recommend the department propose changes in the Administrative Rules of Montana and the Medicaid state plan to enable state institutions to recover all costs allowable under Medicaid regulations.

Response B12-1

Concur. The Department reviewed the federal regulations pertaining to retroactive amendment of the State Plan. The State Plan provides the methodology for Medicaid payments to institutions in which the Health Care Financing Administration (HCFA) participates in funding the federal share of Medicaid expenditures.

In order to obtain additional federal funding for increased Medicaid payments, both the Administrative Rules of Montana and the State Plan must be amended. Changes to the State Plan require approval by HCFA. Unfortunately, State Plan changes are subject to the provisions of 42 CFR 447.256 which state in part:

> (c) Effective Date. A State Plan amendment that is approved will become effective not earlier than the first day of the calendar quarter in which an approved amendment is submitted in accordance with 45 CFR 201.3(g) and 447.253.

The above cited regulation prohibits seeking additional federal reimbursement for prior years.

It is the Department's policy to maximize Federal matching payments. Accordingly, since 1982 the Department has been reimbursing ICF-MR institutions on a cost based system which incorporated a limiting inflationary growth factor. It was believed that the limiting factors would more than provide for any and all cost growth that would be experienced by these institutions.

In 1983 the Federal regulations incorporated upper payment limits for payments to long-term care facilities. The upper limiting factor for ICF-MR institutions could not exceed the Medicare market basket rate of increase from the base year. Inflationary rates used as limiting factors for these institutions in 1987 and 1988 were approved by the Federal Government through the state plan process.

In 1989 when the possibility that our rates might not be sufficient to cover costs for these institutions was brought to the Department's attention, the Department did designate FY 1989 as a new base year upon which to evaluate costs. As a new base year is in effect, these institutions will be reimbursed on a reasonable cost basis without a inflationary limiting factor.

B12-2.
Grant Close Out

When the Montana Department of Community Affairs (DCA) merged into the Department of Commerce in 1981, SRS assumed administrative responsibility for certain grants. These grants include the Low Income Housing Energy Assistance program (CFDA #13.789) and the Weatherization program (CFDA #81.042) presently administered by the department. The responsibility included monitoring subrecipient final reports and collecting unused subrecipient grant funds. During our last audit, agency personnel estimated that the state expended and could recover from the federal government $463,169 for indirect costs on these grants. The personnel believed that the $463,169 could be transferred to the General Fund when the grants are closed. Although the department concurred with our recommendation to close the grants and deposit the indirect cost reimbursements in the General Fund, SRS still has a cash balance of $420,798 in the Special Revenue Fund connected with these grants.

SRS has not completed the recovery process by closing the grants and depositing the money in the General Fund. State law requires grantee agencies to negotiate indirect cost rates and endeavor, to the fullest extent possible, to recover indirect costs of federal assistance programs. In October 1983, SRS management directed its fiscal bureau staff to contact federal program auditors and submit a written claim for indirect cost moneys. A department official said federal personnel were contacted by phone several years ago, and again in the past year. Federal officials involved with one of the grants responded in June 1989. However, the department has not been contacted by federal agencies concerning closeouts of the other Community

Affairs grants. The department official said SRS did not initiate additional actions during the audit period because the individual assigned the task was delegated other administrative duties.

Recommendation B12-2

We recommend the department close the Department of Community Affairs grants and deposit the indirect cost reimbursements in the General Fund.

Response B12-2
Concur. The grant closure process will be completed in July, 1990.

B12-3. Federal Reports

The federal government requires state agencies to report periodically on the financial status of grants received by the state. As a recipient of federal financial assistance, the department is required by federal regulations to account for grant funds in the same way it accounts for its other funds. To ensure federal expenditures are properly reported, these expenditures should be supported by the state's accounting records.

Federal financial reports for the Medicaid program did not include all financial information connected with the developmental disabilities medicaid waiver program (CFDA #13.714). Prior year adjustments shown on the state's accounting records were not included on the federal financial reports. These prior year adjustments would have reduced Medicaid program expenditures. As a result, the department reported $39,837 and $48,409 in excess of the federal share of Medicaid expenditures for fiscal years 1987-88 and 1988-89 respectively. According to department personnel who prepared the reports, the department used expenditure data from the department's data base system rather than from the financial accounting system. We question the allowability of $88,246 in Medicaid program expenditures.

We also noted other instances where financial information in reports to the federal government were not supported by the state's accounting records. In fiscal year 1987-88, Food Stamp (CFDA #10.561) operations expenditures were overstated by $6,856 on the federal report. In addition, Aid to Families with Dependent Children (CFDA #13.780) expenditures were understated by $13,498 in fiscal year 1988-89 on the federal report. As a result, the federal share of program costs reported to the federal government was overstated by $3,428 for Food Stamps and understated by $6,749 for AFDC. We question $3,428 in food stamp costs. Department personnel attributed these situations to human error.

The department prepares an annual report on the Elderly and Handicapped Medicaid Waiver (CFDA #13.714). We determined that the waiver expenditures reported in the 1986-87 and 1987-88 waiver fiscal years were less than those recorded on the state's accounting records by $12,878 and $463,533, respectively. The department filed an amended report for the 1987-88 waiver year. A department official said this difference was caused by a computer programming error. The official attributed the other difference to the timing of adjustments and to the use of a fiscal year other than that used by the state or the federal government for the waiver program. We discuss the waiver fiscal year in section B12-9b. We also noted that the 1987-88 annual report was submitted 30 days later than the date specified in federal regulations. A department manager said employee turnover delayed completion of the report.

Recommendation B12-3

We recommend the department:

A. Adopt procedures to ensure the state's accounting records support federal reports.

B. Request $6,749 in reimbursement for underreported Aid to Families with Dependent Children funds.

C. Submit federal reports in a timely manner.

Response B12-3

A. Concur. Procedures have been established to ensure accurate preparation of the federal report. The HCFA-64 has been adjusted to reflect the prior year adjustments.

B. Concur. Request for reimbursement of these funds was completed in the October 1989 quarter.

The $3,428 in Food Stamp costs was accounted for by filing a corrected Federal report, Form 270 on July 20, 1989.

C. Concur. The Department has hired a contractor to do the computer programming necessary for the federal reports. Completion will be timely for filing of the next federal report.

B12-4. Cash Management

Federal regulations require recipients of federal funds to minimize the time elapsing between the receipt and disbursement of federal cash. Department personnel receive the money by electronic transfer authorized under several letter of credit agreements with the federal government. All federal moneys are deposited in one accounting entity in the department's Special Revenue Fund.

At the close of fiscal year 1987-88, department personnel discovered that they had drawn $5,849,056 in excess Medicaid (CFDA #13.714) cash. The situation occurred because the department calculates Medicaid cash withdrawals using the federal financial participation (FFP) rate in effect for the fiscal year in which service claims are paid. The FFP rate for Medicaid expenditures, however, is determined based on the date the service was provided rather than the date on which the service claims are paid. The department should have adjusted the cash withdrawals to reflect the difference between the current FFP rates and date of service FFP rates. According to department officials, personnel overlooked making the adjustment at fiscal year-end. We observed that the department reduced the excess federal cash balance in August 1988 by offsetting the overdrawn amounts against current cash needs.

Recommendation B12-4

We recommend the department implement procedures to ensure compliance with federal cash management regulations.

Response B12-4

Concur. The Department will complete the reconciliation before each fiscal year end. This will eliminate the possibility of the reoccurrence of the error.

B12-5. Quality Control Reviews

Federal regulations require SRS personnel to review client case files to ensure that eligibility and benefits for Medicaid (CFDA #13.714), AFDC (CFDA #13.780) and Food Stamp (CFDA #10.551) clients are properly determined. SRS performs these quality control reviews on random samples of client case files. SRS draws the samples monthly according to a federally approved plan.

As part of the quality control review, the reviewer recalculates the benefits paid to the client. According to federal regulations, a client's benefits are determined to be incorrectly computed if the difference between the benefits paid and the recalculated amount exceeds five dollars. We found two instances in the 40 AFDC and Food Stamps cases we tested where case errors were not properly reported to federal agencies. The instances are described below.

- SRS quality control reviewers noted an error in income calculation in one case file. The error caused the department to pay excess AFDC and Food Stamp benefits. After considering the response of county eligibility personnel to the error, the department documented that the error was less than originally noted but still in excess of the five dollar limit for reportable errors. However, the department recorded the case as a "no error" case for quality control purposes.

- Federal regulations require that the reviewer verify ownership, license, use status, and value for all vehicles owned by the recipient's household members. In one case neither the eligibility technician nor the quality control reviewer detected a car registered to the client's wife. As a result, the household received benefits for two months for which it was ineligible. The department recorded the case as "no error" because the error was not detected by the reviewer.

A department official said neither case was reported to the federal government because of oversights within the department. The department recovered overpayments from the clients in accordance with federal regulations.

Recommendation B12-5

We recommend the department:

A. Report all quality control errors as required by federal regulations.

B. Ensure eligibility technicians and quality control reviewers verify vehicle ownership, license, use status, and value as required by federal regulations.

Response B12-5

A. Concur. The report omission was due to human error. The overpayments were recovered from the clients.

B. Concur. It is the Department's policy to verify vehicle ownership, licensure, use status, and value as required by Federal regulations. Policy will be reiterated at quarterly Corrective Action meetings.

B12-6. Federal Funds Carryover

SRS administers the Low Income Home Energy Assistance Program (CFDA #13.789). LIHEAP, funded by a block grant from the federal Department of Health and Human Services, provides assistance to low income households to pay heating costs during the winter. SRS receives a block grant allotment each year to operate LIHEAP in Montana. Federal regulations allow the department to reallocate and spend in the subsequent year an amount not to exceed 15 percent of the previous year's block grant allotment.

In federal fiscal year 1987-88, the department reallocated $31,207 more than the 15 percent limit set by federal regulations. When these funds were spent in the following fiscal year, the expenditures were not allowable because SRS did not have the federal spending authority. Therefore, we question the allowability of $31,207 in LIHEAP expenditures.

Although the department records LIHEAP grant expenditures on the state's accounting records, a department official said that these records were not reviewed to ensure unspent block grant funds were properly reallocated. The official noted that the U.S. Department of Health and Human Services increased the federal fiscal year 1987-88 LIHEAP allotment by $97,897 on September 23, 1988. As a result, SRS had only a week to commit these funds before the end of the federal fiscal year.

Recommendation B12-6

We recommend the department monitor financial records to ensure the Low Income Home Energy Assistance Program reallocation complies with federal regulations.

Response B12-6
Concur. Such a procedure has been established.

B12-7. Food Distribution Program

SRS receives food commodities from the U.S. Department of Agriculture for distribution to Indian reservations, charitable and state institutions, nutrition programs for the elderly, and nonprofit summer camps. An objective of the Food Distribution Program is to improve the diets of children and other needy persons not participating in the Food Stamps Program. In fiscal years 1987-88 and 1988-89, the department distributed $7.1 and $4.4 million, respectively, in food commodities from its Helena warehouse. The following four report sections discuss compliance and control concerns related to the Food Distribution Program.

B12-7a. Inventory Systems

The department maintains three separate inventory systems for food commodity inventories (CFDA #10.550). One system is maintained on the state's mainframe computer and the other two are manual systems. Department personnel said the computer system is not reliable, but is used to generate forms and reports.

In addition, a department official indicated the department maintains duplicate manual systems at the program office and the warehouse to ensure the records are available if those at the warehouse are accidently destroyed. We recommended the department eliminate this duplication in our prior audit. The department concurred with the recommendation. A department official said there had not been sufficient staff time to address the issue. We estimate that the duplicate inventory systems cost the department $7,700 in personnel time annually.

Recommendation B12-7a

We recommend the department maintain only one food commodity inventory record keeping system.

Response B12-7a

Concur. As stated in the previous audit report, we reviewed options available and found that a new system would not significantly aid in our efforts. The changes made in January 1989 have improved the integrity as well as reducing the inventory error rate, which has reduced the time required to complete month-end inventories.

B12-7b. Distribution Controls

Federal regulations require state agencies and their subrecipients to maintain records to document the receipt, disposal and inventory of donated foods. These regulations also state that the failure of a distributing agency to maintain accurate and complete records shall be considered prima facie evidence of improper distribution or loss of donated food by the agency. If this occurs, the department can be held liable for the cost of lost or improperly distributed food commodities.

The department uses a standard requisition form to maintain control over distribution of food commodities (CFDA #10.550) to subrecipients. The subrecipient agent initiates a requisition

by entering the food items with quantities requested on the form, signing the form, and sending it to the department's program office in Helena. SRS staff assign a number to each requisition, but do not always authorize the requisition by signature before forwarding it to the warehouse for shipment. Department policy directs the subrecipient agent to sign the shipping invoice upon receipt of the food commodities and indicate the amount received on the form. We tested a random sample of orders from the distribution log. Of the 26 orders tested, eight documents did not have the subrecipients' signature of receipt.

In addition, we noted that the department had not implemented a prior audit recommendation that recommended the department require signature approval of food commodity requisitions. During the prior audit, department personnel indicated approval of a food commodity requisition occurs when department employees put a sequential number on the requisition. The official indicated since all requisitions are logged in at the warehouse, personnel at the warehouse would detect fictitious requisitions if the requisition number is not in the proper sequence. We question the effectiveness of this control because we observed four gaps in the numbering sequence of requisitions in the requisition log. The gaps ranged in size from as small as one to as large as 900 requisition forms.

A department official said one individual has been assigned the duty of approving commodity requisitions and recording the assigned requisition number in the log. This individual does not always sign the log. The requisitions are signed if someone other than the assigned individual logs the requisition. The official attributed the gaps in log numbering to human error. Accountability for food commodities can be improved if all requisitions are signed by an authorized individual.

Recommendation B12-7b

We recommend the department:

A. Implement signature approval for all commodity distributions.

B. Require its employees to follow prescribed commodity distribution recordkeeping procedures.

Response B12-7b

A. Concur. The reorganization of job functions in January 1989 identified one position that would be primarily responsible for food order processing. If a position other than the primary position processed an order, then that person was/is to initial the order. Other concerns have been identified that will necessitate signature approval at each step of the other processing.

B. Concur. This agency's procedures are changed as federal regulations and policy changes occur.

B12-7c.
Expired Food Commodity Contracts

SRS allowed contracts with food commodity (CFDA #10.550) subrecipients to expire during fiscal year 1988-89. Of 55 subrecipients tested, 32 had received food commodity shipments during periods when contracts with SRS had expired.

The department executes contracts with food commodity subrecipient agencies. The purpose of the contracts is to ensure that organizations which receive food commodities are eligible in accordance with federal regulations. Without a current contract, the department does not have assurance that subrecipients remain eligible to use or distribute food commodities.

According to a department official, the individual monitoring the contract file did not start to update contracts in the file until

after the expiration dates. The official said the problem was compounded by staff turnover in that position. We reported this internal control weakness in our prior audit report. The department concurred with our audit recommendation but did not implement it.

Recommendation B12-7c

We recommend the department maintain current contracts for subrecipients receiving food commodity distributions.

Response B12-7c

Concur. Although a procedure was put in place to correct this finding in the last audit, it has been modified again to improve contract controls.

B12-7d.
Tribal Government Audits

The department has no procedure for obtaining and monitoring audit reports of tribal governments performed under the provisions of Office of Management and Budget (OMB) Circular A-128. This circular establishes federal audit requirements for state and local governmental units which receive federal funds. Tribal governments receive food commodity distributions (CFDA #10.567) from the department. The department, as the recipient of federal assistance, is required by federal regulations to have a system of monitoring subrecipients such as tribal governments.

One method the department can use to monitor tribal governments is to review audit reports of the tribal government. These audit reports are already required by federal regulations. By inserting a clause in the food distribution contracts with tribal governments requiring that copies of audits of the tribal governments be submitted to SRS, the department can ensure these reports would be available for use as a monitoring tool. Through review of these reports, department personnel could

detect instances where the tribes may not be in compliance with federal regulations and note disclosures of internal control weaknesses or questioned costs. A program manager said the department will amend the fiscal year 1989-90 food distribution contracts with the tribal governments to require that copies of tribal audits be sent to SRS.

In the last audit we recommended the department obtain and review audit reports of tribal governments as required by OMB Circular A-128. The department has received an audit report from only one of the six tribal governments with which they have a contract. The circular requires subrecipients to send a copy of their single audit report to those agencies that provided federal funds. However, the department should also include specific language in its contracts with tribal governments requiring that the tribe send a copy of the audit report to the department to help ensure the tribes submit the report for timely review.

Recommendation B12-7d

We recommend the department obtain and review audit reports of tribal governments as required by OMB Circular A-128.

Response B12-7d

Concur. In March, 1990 contract amendments specifically requiring that report were mailed to the tribal governments.

B12-8. Food Stamp Program

Montana's Food Stamp program is designed to supplement the food budgets of low income households. The department receives food stamps and funds to administer the program from the U.S. Department of Agriculture. Through contracts with counties or other local agents, the department distributes food stamps to eligible low income households. Department person-

nel direct the eligibility determination process and oversee monitoring of the Food Stamp program in the state. In fiscal years 1987-88 and 1988-89, SRS distributed $35,249,256 and $35,507,662, respectively, in food stamps and received $5,365,765 and $4,915,921, respectively, in administrative funding for the Food Stamp program. The following three sections discuss situations in which controls over Food Stamps can be improved.

B12-8a. Food Stamp Issuance Controls

Federal regulations provide three alternative methods for issuing food stamps (CFDA # 10.551). One of these issuing methods involves the use of Authorization to Participate (ATP) cards. Department personnel at county offices issue ATP cards to eligible clients each month by mail. Clients present the ATP card to the issuance agent to receive the authorized allotment of food stamps. The issuance agent cancels the ATP cards and issues the food stamps. When the agent returns the cancelled ATP cards to the department, department personnel reconcile ATP logs and issuance records. This procedure provides segregation of duties between authorization of food stamp issuance, custody of food stamps and accounting for food stamp issuance transactions.

In one county with an average monthly food stamp issuance of $13,155, we observed conditions that did not maintain the segregation of duties described above. One employee had custody of both blank ATP cards and food stamps. The individual prepared ATP cards for mailing, issued food stamps and reconciled ATP card and food stamp issuance records. As a result, the employee could authorize food stamp issuances to fictitious or ineligible individuals.

Department personnel said the situation occurred after the county office assumed the food stamp issuance function discontinued by a contract agent. A department official said the department's office in the county did not have sufficient staff to separate eligibility determination, ATP and food stamp issuance functions. We believe the department should consider restrict-

ing issuance hours so that employee responsibilities could be reallocated to properly segregate duties. With a staff of three, the office could implement some segregation of duties. Mail issuance of food stamps as an alternative has been rejected by the county commissioners because of concerns about the security of food stamps at the postal delivery locations.

Recommendation B12-8a

We recommend the department maintain adequate internal controls over food stamp issuances.

Response B12-8a

Concur. The Division sent a letter, on March 23, 1990, to all counties reminding them of the need to separate functions relating to the issuance of food stamps. There are some small counties where there is no economical way to separate the issuance functions. In these counties, the best possible practice will be followed.

B12-8b.
Other Food Stamp Issues

The federal Single Audit Act requires that all instances of noncompliance with federal regulations noted during the audit be reported. The food stamp (CFDA #10.551) related issues described below do not indicate significant control problems at the department, but are cases where the department did not comply with applicable federal regulations.

- In one county, we found the issuance agent issued two \$10 books instead of two \$7 books of food stamps. An overissuance in excess of \$5 counts as an issuance error under federal regulations. County officials cited human error as the cause of the overissuance.

- Federal regulations require the department to monitor the inventory activities of food stamp issuance agents for reasonableness of inventory amounts. The regulations limit inventory levels at coupon issuers and the bulk storage point to a six month supply. Of the five

counties we tested for inventory levels in fiscal year 1988-89, one county had in excess of six months supply of coupons in three of the six coupon denominations.

Recommendation B12-8b

We recommend the department comply with federal regulations concerning food stamp issuance and inventory levels.

Response B12-8b

Concur. A letter of instruction was sent on March 23, 1990 to all issuance offices with a reminder of the ordering guidelines requirements.

B12-9. Medicaid Waivers

The department operates two programs funded by Medicaid which supply services to clients in residential settings. The department expended $3,273,361 and $4,727,606 for the elderly and handicapped and developmental disabilities waivers, respectively, in the most recent waiver years. The programs allow developmentally disabled and elderly or handicapped persons to live in homes rather than institutions. Federal regulations permit the state to operate these programs with Medicaid support as long as the costs of doing so are less than those of providing services to the affected clients in institutions.

B12-9a. Case Management Services

SRS obtains case management services for developmentally disabled clients through a contract with the Department of Family Services (DFS). DFS provides these services to 1,467 developmentally disabled clients, of whom 186 participate in the waiver program. Department management estimated it costs $165,000 per year to provide case management services for this Medicaid Waiver Program (CFDA #13.714). SRS records the amounts paid for case management services as a Medicaid administrative expenditure. In a recent program review, Health

Care Financing Agency (HCFA) officials indicated that expenditures for case management services are not considered allowable administrative costs. However, the HCFA report said expenditures for case management services could be properly claimed as program costs rather than administrative costs under the waiver program.

If these costs had been claimed as program costs, the federal government would have reimbursed the department approximately 70 percent of the costs for the past two federal fiscal years rather than only 50 percent at the administrative cost rate. At the higher rates, department officials estimated SRS would have received approximately $32,000 more in each fiscal year.

According to department officials, the case management costs have not been billed as a program cost under the waiver because the random time motion study used to bill social worker time does not adequately distinguish between waiver and nonwaiver clients. The official said that the department has established a task force to improve case management operations under the Medicaid plan. The task force will consider how to bill for case management costs at the program rate.

Recommendation B12-9a

We recommend the department implement procedures to ensure it receives reimbursement of case management costs for developmental disability waiver recipients at the proper Medicaid rate.

Response B12-9a

Concur. In 1991 the Department will request legislative approval to provide "Targeted Case Management" to all individuals served by the developmental disabilities service system (not just waiver clients) as an optional service under the medicaid state plan.

The Department currently provides case management service to 99 children under the developmental disabilities waiver. Other individuals receiving services through the developmental disabilities service system, approximately 1400 people, receive case management services from Department of Family Services social workers. Medicaid has paid for these administrative activities, documented by a random moment time study, at a 50/50 matching rate.

Case management funded under the waiver for the other 190 waiver recipients has not been an option because the service has historically been provided under other funding sources and HCFA will not allow cost shifting. Case management at the 30/70 matching rate under the state plan has not been an option because the Montana legislature stipulated that no new services could be provided by Medicaid without its express approval.

The Department will request legislative approval to provide case management as a regular medicaid state plan service to all individuals with developmental disabilities. This option will provide a more favorable federal matching rate, thereby providing for better quality services.

B12-9b.
Waiver Year

The Elderly and Handicapped Medicaid Waiver program (CFDA #13.714) operates on a November 1st through October 31st fiscal year rather than the federal or state fiscal year. Federal regulations require that the department submit an annual report within six months after the close of the waiver year. During an independent assessment of the elderly and handicapped waiver, we reviewed the annual reports submitted to HCFA for the waiver years ended October 31, 1987 and October 31, 1988. We also noted that the department had difficulty in reconciling the expenditures reported on the annual report to expenditures recorded in the state's accounting records, because the fiscal year for the waiver program is different from both the state's fiscal year and the federal government's fiscal year.

Since the Medicaid waiver annual report shows the cost of services provided during the waiver year, SRS extracts these costs from the paid claims computer tape based on the dates the services were provided, and a code used to describe services provided under the waiver program. The state's accounting records also accumulate various Medicaid costs by service type and date of service. However, the costs on the state's records are accumulated for service dates that coincide with the state's fiscal year and the federal fiscal year but do not coincide with the waiver year. As a result, special computer programming is necessary to extract waiver expenditures for the annual report. Further work is necessary to reconcile the report data to the expenditures recorded on the state's accounting records.

Additional staff and computer costs as well as increased risk of reporting error could be avoided if the elderly and handicapped waiver program were reported to the federal government using the federal or state fiscal year. We estimate that the nonstandard waiver fiscal year costs the state $1,500 in personnel costs annually. A department official indicated the department would need federal approval before it could change the wavier program to a federal or state fiscal year.

Recommendation B12-9b

We recommend the department seek written federal approval to operate the elderly and handicapped waiver on a federal or state fiscal year to reduce operating costs.

Response B12-9b

Concur. The Department has submitted the request and received approval from the federal government to change the report year to the federal year effective October 1, 1989.

B12-9c.
Waiver Payment Controls

SRS contracts with a computer services facility to process Medicaid (CFDA #13.714) claims. The firm operates a computerized claims processing system which contains computer edits designed to ensure benefit payments comply with federal and state laws and regulations. The system generates a magnetic tape of amounts to be paid to Medicaid service providers, including those performing services for participants in the elderly and handicapped waiver program. The claims are then paid through the state's warrant system.

We examined the files of 62 elderly and handicapped waiver clients and found all were eligible to receive waiver benefits. However, in tests of expenditure transactions related to these clients, we noted several situations where benefit payments were made even though the transactions were not properly authorized by case management personnel. These situations are discussed below.

- We observed nine claims that had not been authorized by case management personnel at the time payments were made. Four of the claims were approved subsequent to payment and five were not approved. State policy requires case management personnel to authorize these waiver claims. Personnel at the computer services facility attributed the payment of unauthorized claims to human error and to the large claims volume handled.

- We tested the use of system edits by keypunch operators at the computer services facility. We noted that the system contained no prompts on the computer screen which would require the keypunch operator to check the claim form for proper authorization before entering the claim on the system. We observed this occurring only for transactions involving certain nursing transaction codes. A claim for this type of service that we traced from a client file had not been authorized by the case management team. A department official said the department did not specifically request that the computer service facility include a screen prompt to check for proper authorization. Based on our observations, we noted data processing input screens usually have a prompt to check for proper authorization.

- One provider invoice included a service not specified on the client's plan of care. Although a case management employee reviewed the invoice and noted the unallowable charge which was less than $10, the computer services facility personnel paid the charge along with other allowable items. Computer services facility personnel said data entry operators exclude charges only if a line is drawn through them. According to the computer services facility management, other methods of documenting denial of charges may be overlooked because of the speed with which operators work to keep up with claims volume. The department should adopt and communicate to all personnel a procedure for marking denied claim items.

- The computer services facility processed claims for a provider who did not have a provider enrollment form on file. Under federal regulations only providers who meet Medicaid standards for specific services may receive Medicaid payment for these services. Since the computer services facility had no enrollment form on file, the department could not document that the provider met the qualifications set in federal regulations to receive payment for the services provided.

The department is responsible for the adequacy of internal control procedures over waiver expenditures. Since case management and claims processing services are provided by parties under contract with the department, the instances above indicate the department should communicate procedures to the contractors so the desired controls are implemented.

Recommendation B12-9c

We recommend the department communicate control procedures for authorization of elderly and handicapped waiver expenditures to contractors and ensure contractors implement them effectively.

Response B12-9c

Concur. Department personnel will review the control procedures in general, and the audit findings in particular, with the contractors as contracts are renewed and audits completed.

B12-10.
Contingent Revolving Fund

The department maintains a contingent revolving fund (CRF); a checking account outside the state treasury. SRS expended $11,232,000 through this account in fiscal year 1988-89. We reviewed CRF internal controls at the department, at four state assumed counties, and at six nonassumed counties. Based on our review, we determined there are internal control weaknesses in the operations of the contingent revolving fund. The department uses the CRF predominantly for general assistance and the Aid to Families with Dependent Children (AFDC) Program (CFDA #13.780) payments. The department also uses the fund for administrative purposes where cash is needed immediately, such as to pay unforeseen travel expenses. Each county and district office has its own supply of checks which can be written on the account. In each of the last three audits of the department and during the current audit, we observed internal control weaknesses which could allow persons working at the department offices to write unauthorized CRF checks. The following two sections discuss our concerns and suggestions for improvement in the internal control system for the CRF.

B12-10a.
Segregation of Duties

State policy requires that different personnel should have the responsibility for authorizing transactions, keeping accounting records, and maintaining security of assets if staffing levels permit. By segregating employee duties, the department increases assurance that funds are properly used because more than one person must participate in each transaction. We noted the following instances where an inadequate segregation of duties exists:

- At three counties eligibility technicians (ET) determine eligibility and sign CRF checks for individuals in their caseload. These employees could authorize and make

payments to unauthorized or fictitious individuals which may not be detected.

- At one county, a clerical employee has access to the blank checks and is an authorized signer for the CRF. One individual with these duties has the ability to make unauthorized payments.

Some human service office personnel were not aware of the importance of segregation of duties as a means to prevent and detect errors and irregularities. County personnel also cited the small number of staff in their offices as a reason for not segregating duties. Since most offices have at least two or three staff, we believe a more effective segregation of duties is possible. Department officials should separate incompatible duties such as determining client eligibility and signing CRF checks to improve controls over the CRF. The department should also separate the accountability for the security of blank checks from the individual who has authority to sign the checks.

Recommendation B12-10a

We recommend the department segregate incompatible staff duties to improve the security of Contingent Revolving Fund moneys.

Response B12-10a

Concur. Counties have been notified, in the past, by Area Supervisors and through audit findings that authorization and preparation of First Checks should be done by separate staff persons. The Division will continue reminding the counties of this requirement at periodic Corrective Action meetings. There are some very small counties where no feasible way of separating functions is possible. In these counties, the best possible practice will be accepted.

**B12-10b.
Check Lists**

SRS prepares a monthly list of CRF checks processed by each county. By using the processed check list, field office personnel can compare the list of checks processed with their records to ensure that only properly authorized checks were processed. In our audit, we found that none of the state assumed counties were receiving the processed check list. Only three of the five nonassumed counties that we visited which receive the list were using the list as intended. An official at one nonassumed county said their office had not received the list for quite a while. In counties which received but did not use the processed check list, officials did not understand how the list was intended to be used.

Department personnel in Helena said the state assumed counties did not receive the list because it was sent out with the monthly county billings. State assumed counties do not receive these billings because the state operates the human services offices in these counties directly. The department now sends the processed check lists to state assumed counties. According to department officials, the department did not successfully implement use of the processed check list as a control procedure because the initial memorandum, provided to county personnel describing the check comparison procedures, did not explain why or how the comparison should be made.

Recommendation B12-10b

We recommend the department ensure that CRF transactions are valid by comparing the processed check list to CRF check logs at each county.

Response B12-10b

Concur. Counties have been instructed to perform this comparison. The Division will coordinate with Fiscal Bureau to assure that the lists are sent and that counties receive instructions on how to use them.

**B12-11.
TEAMS Accrual**

Department accountants accrued contracted services and equipment expenditures in fiscal year 1987-88 related to the development of The Economic Assistance Management System (TEAMS). The accrual increased expenditures by $378,427 and $2,439,047 in the General Fund and Special Revenue Fund, respectively. TEAMS funding included moneys from Medicaid (CFDA #13.714) Aid to Families with Dependent Children (CFDA #13.780), and Food Stamps (CFDA #10.561). We determined that these expenditures did not meet state policy requirements for accrual.

State policy requires that an expenditure be a valid obligation of the state if it is to be accrued at year end. For contracted services only commitments related to unperformed, legally-binding contracts in process at year-end are valid obligations. The contracted services portion of the TEAMS accrual was not supported by valid contracts. State policy also states that equipment should, as a general rule, be charged against the fiscal year in which a purchase order was issued. Some of the equipment expenditures accrued for TEAMS were not supported by purchase orders.

According to one agency official, the department accrued the expenditures to prevent the loss of its appropriation authority for the TEAMS project. Another official said that such an accrual is permissible for legislative project appropriations. We were unable to find specific mention of the TEAMS project in the appropriation laws or state statute.

Recommendation B12-11

We recommend the department accrue expenditures only for valid obligations as required by state accounting policy.

Response B12-11

Concur. The Department will make no further charges to the contested accruals. The Department will back-out, by June 30, 1990 fiscal year-end all charges that have been assigned to the contested appropriation, excepting those charges that were made pursuant to valid obligations created before the end of the FY 1988-89 biennium, are reassign those charges to the TEAMS FY90 appropriation.

B12-12. Other Federal Compliance Issues

SRS receives financial assistance from several federal agencies for various human service programs. Federal regulations specify that grant expenditures are not allowable for federal reimbursement unless the expenditures are made in accordance with state law. We observed a situation where department noncompliance with state law caused us to question the allowability of certain costs.

The department overexpended the operating expense budget for its visual services program by 6 percent in fiscal year 1987-88. The appropriation law allows agencies to overspend operating plan line items by 5 percent. As a result, the department expended $1,437 above the budgeted limit for the affected appropriation. This amount constitutes a questioned cost for the vocational rehabilitation grant (CFDA #84.126). Department management said the situation was caused by human error.

Recommendation B12-12

We recommend the department comply with appropriation laws regarding operating budget limitations.

Response B12-12

Concur. Upon notification of the discrepancy, Program instituted a review procedure to prevent this from happening in the future.

**B12-13.
Data Processing
Security**

We identified several situations where controls over access to department's electronic data processing (EDP) systems and data could be improved. The EDP systems used by SRS contain information for services administered through the department. The department maintains essential data concerning recipients who receive benefit payments on its EDP system. Benefit payments made from the state General Fund and the Federal Special Revenue Fund exceed $250 million each year. Federal benefits paid through these systems were provided by the U.S. Department of Health and Human Services and the Department of Education. Examples of information on the system include recipient's name, income, medical and other services provided, and benefit payment amounts. Some of this information is confidential and should be adequately safeguarded. We noted weaknesses in controls which could allow unauthorized persons access to sensitive information and allow incorrect payments under the various programs administered by the department. Similar weaknesses were noted in our last audit.

Computer access controls help prevent deliberate and accidental use of the data files. Access controls are physical or electronic safeguards designed to ensure computer system resources are properly used. Access controls consist of input controls instituted by the department for each application as well as access controls governed by ACF2, the state's mainframe computer security software. The problems identified during our audit increase the potential for unauthorized use of department data and programs. The following sections discuss concerns found during our audit.

**B12-13a.
ACF2 Rules**

We reviewed the department's ACF2 access rules. In our examination, we identified the following concerns:

- A department official said that all agency programmers have full access to all data and programs for critical applications when they are hired. Such access allows programmers to change data as well as programs. A

contracted services employee working as a programmer also has access to data. In addition, the data processing secretary has full access to all data. Access to data by employees who do not need such access to perform their job increases the risk that data will be altered without proper authorization. Access to data files and programs should be limited to those individuals authorized to process or maintain particular systems. Normally two programmers are assigned responsibility for maintaining particular computer applications. These individuals should be given access only to programs which they are responsible for maintaining. Frequently programmers do not need access to data files because other department personnel are responsible for entering or changing the data. Therefore, department computer security personnel should evaluate whether individual programmers need access to all data sets for applications they maintain.

- Of 17 ACF2 access rules related to users outside the department, 11 granted more access to the users than required. In several instances, individuals with ACF2 access no longer performed the tasks requiring access to certain computer files. In one case the department gave access to an individual from another agency to perform a study. Although the study was complete, the individual still had access. To improve system security, user access should be limited to the level necessary for the users to perform their jobs.

According to a department official, programmers are given access to all datasets so the department will have greater flexibility in assigning personnel in an emergency when prompt recovery is desired. We agree there are occasions when programmers need access to certain data files, however this should be an exception and not the rule. If computer programmers need access to data files, such access should be reviewed and approved on a case by case basis. A system should be devised by the department to ensure programmers have access to appropriate program and data files in emergencies.

Section 53-3-111, MCA, specifically requires that certain information be kept confidential and access to it be restricted. When security rules permit more access to computer data files than

required, the department increases the risk that unauthorized changes will be made to the data. These unauthorized changes may not be detected by department management.

Recommendation B12-13a

We recommend the department:

A. Limit computer access of its programmers to the systems the individuals are assigned to maintain.

B. Ensure the access of programmers outside the department is cancelled when their work is completed.

Response B12-13a

A. Partially concur. The management intent is that all systems and programming personnel be able to work on any system at any time. The current flexibility is needed to cope with a workload that exceeds personnel resources.

Implementation of this recommendation is not practical in our work environment due to our data processing programs inter-relationships and dependency upon each other. The majority of our major systems are old, difficult to maintain, and error prone.

B. Concur. Upon completion of training the Departments new Security Officer will review and update other departments use of SRS data. The Security Officer will use an ACF/2 feature that automatically terminates security access for specified short-term use. This should ensure access is cancelled when work is completed.

B12-13b.
Security Officer Function

An ACF2 security officer can access all data and program files within an agency. Because the security officer has access to all system files, it is important that the security officer duties be segregated from other data processing functions. The segregation of duties between the programmer and security officer limits the ability of one person to perpetrate errors or irregularities and then conceal those errors or irregularities. The department mainframe security officer and backup security officer both are programmers.

The security officers have access to all files. A programmer with this unrestricted access has the greatest ability to alter files on a computer system and then conceal the fact that the files were changed. Department management said the department did not select a security officer from outside the EDP function because the job requires .5 FTE. The time commitment did not fit into existing job descriptions. We believe the department could segregate the security officer function from the EDP function by reassigning duties between existing positions.

Recommendation B12-13b

We recommend the department segregate the security officer function from other EDP functions.

Response B12-13b
Concur. In March, 1990 the Department has moved the Backup Security Officer function from a Systems Analyst to the Supervisor of Computer Operations. The Department intends to move the entire Security Officer function out of the Systems and Programming Section after the Supervisor of Computer Operations is trained and demonstrates the ability to handle the work. Eventually, the Department may have a full-time Security Officer for mainframe and microcomputer applications.

B12-13c.
Disaster Recovery

Section 2-15-114, MCA, requires all state agencies to implement safeguards to reduce, eliminate, or recover from threats to data and information. State policy provides a detailed description of the disaster recovery process required for systems designated as critical by the agency. This policy requires the agency to test each critical application at the backup computer facility.

Although the department has drafted a disaster recovery plan, it has not been tested. Therefore, the department may be unable to efficiently resume operations after an event that significantly damages the EDP system. A plan for recovery of EDP operations after a disaster is a key part of providing security over EDP functions. According to a department official, the department has not had sufficient personnel resources to test their plan.

Recommendation B12-13c

We recommend the department test its EDP backup and recovery plans for its critical mainframe applications.

Response B12-13c

Concur. The draft disaster recovery plan for mainframe computer applications has not been tested because it is not current. A contractor was hired to perform an estimated two month preliminary analysis of what is needed to update the disaster recovery plan. The contractor has not started work on this phase of the contract. The Department will decide what action is needed after receiving the contractor's recommendations, due in June 1990, and alternatives. The Department concurs that backup procedures for critical systems need to be tested after an adequate disaster recovery plan is developed.

**B12-14.
Fund Balances**

One of the department's Federal Special Revenue Fund accounting entities did not have a zero fund balance at fiscal year-end during either year of our audit period. The accounting entity is used by the department to account for its federal public welfare grants. The department receives most of the funds flowing through this account from the U.S. Department of Health and Human Services. According to state accounting policy, the fund balance in this entity should be zero by fiscal year-end because federal revenues must equal expenditures. The entity had negative fund balances of $771,923 and $6,074,688 in fiscal years 1987-88 and 1988-89, respectively. A department official indicated that $5,791,937 of the $6,074,688 negative fund balance was caused by not recording receivables from the federal government at fiscal year-end 1988-89. In our previous audit report, we disclosed that the department had an unreconciled fund balance in the federal accounting entity.

We also noted the department has commingled federal moneys with nonfederal money in the federal accounting entity. According to a department official, nonfederal cash has accumulated in the federal accounting entity over a number of years. The department official said the commingling of federal and nonfederal cash is a cause of the unreconciled fund balance in the federal accounting entity. The $771,923 negative fund balance in fiscal year 1987-88 and $282,751 of the $6,074,688 negative fund balance in fiscal year 1988-89 in the federal accounting entity resulted from improper segregation of cash and other resources.

Department officials estimate that it may require up to one half a year of staff time to trace the transactions that caused these problems. We believe the commingling of state and federal cash in the federal accounting entity casts doubt on the adequacy of federal cash management procedures. By not separating federal and nonfederal cash, the department could be required by federal agencies to implement more restrictive cash management procedures. Since the department has been unable to identify the cause of negative fund balances, it was not practical for us

to determine the dollar effect on revenues, expenditures, assets, and liabilities reported in the department's financial records.

Recommendation B12-14

We recommend the department:

A. Analyze and correct account balances in the federal Special Revenue Fund.

B. Reconcile cash in the federal accounting entity to identify the nonfederal cash.

Response B12-14

A. Concur. This analysis will be an agency priority to be completed by July 31, 1990.

B. Partially concur. Technically this is impossible on a daily basis. For example, Medicaid vendor payments are made weekly based on claims processed. Those claims paid in November, 1989 cover services provided in June, 1988, January, 1989, August, 1989 and October, 1989; those time frames cover three different Medicaid FFP rates. As claims are paid, FFP is drawn based on current Federal Year FFP. It is not known until December, 1989 the date-of-service FFP that is correct to have been drawn to cover that period FFP. The funding mix, Federal/State, is corrected quarterly through the cost allocation process.

B12-15. Property, Plant, and Equipment

SRS performs services in all 56 counties of the state. In some locations, employees work with both state and county owned equipment. The department's Centralized Services Division has responsibility for maintaining controls and records related to state-owned equipment. SRS accounting records showed an equipment balance of $2,162,000 at June 30, 1989. The department purchased equipment with moneys from the U.S. Depart-

ment of Health and Human Services and the U.S. Department of Agriculture. In the following three paragraphs, we describe several instances in which the department did not record equipment on the accounting records in accordance with state accounting policy.

- State accounting records understated equipment acquisitions by $16,240 and $198,482 at June 30, 1988 and June 30, 1989, respectively. State policy requires that equipment purchased during the year be included as part of the equipment balance at year end. Personnel responsible for managing and receiving equipment said proper procedures for updating accounting records at fiscal year end had not been communicated to them.

- State policy requires that intangible assets such as computer programs purchased from outside vendors should be recorded in fixed asset records. The department did not record intangible assets of $16,239 and $70,199 in fiscal years 1987-88 and 1988-89, respectively. Department management said that software purchases are received directly by program personnel. As a result, employees responsible for maintaining fixed asset records are not aware of software purchases.

Similar problems related to fixed asset accounting were reported in the last audit. We believe that the department could improve compliance with state accounting policy by implementing procedures to increase communication between accounting personnel and employees managing equipment records. By ensuring that personnel responsible for maintaining inventory records have the necessary knowledge of accounting policies concerning fixed assets, future errors can be avoided.

Recommendation B12-15

We recommend the department:

A. Implement procedures to improve communication among personnel involved in accounting for fixed assets.

B. Provide training in accounting for fixed assets to personnel involved in fixed asset control.

Response B12-15

A. Concur. The procedures to account for fixed assets will be updated by April 18, 1990 and training provided thereafter.

B. A training session will be held on April 18, 1990 to familiarize all involved personnel with fixed asset accounting and control procedures.

B12-16. Accounting Issues

Financial information of the department is used by department officials and legislators to manage and establish funding levels for the department. The department uses the Statewide Budgeting and Accounting System (SBAS) to record its financial activity. Section 17-1-102(4), MCA, indicates: "all state agencies, . . . shall input all necessary transactions to the accounting system . . . before the accounts are closed at the end of the fiscal year in order to present the receipt, use, and disposition of all money and property for which the agency is accountable in accordance with generally accepted accounting principles (GAAP)." State accounting policy requires all financial transactions recorded on SBAS to comply with state law.

We noted the following instances where the amounts recorded on SBAS did not comply with state law:

1. The department receives a portion of child support collections made on behalf of public assistance clients. Federal regulations require that the department pay $50 each month to the family on whose behalf the support was collected. The department recorded these payments as revenue refunds. A department official said these moneys are recorded as refunds because they do not belong to the state. Per federal regulations, they are collected and distributed on behalf of recipients. We believe the benefit established by federal regulation is actually a use of SRS resources which should be recorded as an expenditure. As a result, expenditures and revenues are understated by $130,667 and $90,943 in the General Fund and $14,006 and $9,357 in the Special Revenue Fund in fiscal years 1987-88 and 1988-89, respectively.

2. The department nets certain amounts receivable from the counties against the amounts payable to the counties. Generally accepted accounting principles require that accounts receivable and accounts payable be shown separately on the financial records. Off- setting of the accounts is not permitted. As a result of netting this county financial activity, expenditures and revenue in the Special Revenue Fund were understated by $525,540 and $415,136 in fiscal years 1987-88 and 1988-89, respectively.

   A department official said the expenditures were made by the county and should not be recorded on the state's records. We believe the department, as the recipient of federal (CFDA #13.780 and #10.561) funds and the grantee under the federal programs, should record all expenditure and the revenue activity on its accounting records.

3. In fiscal year 1988-89, department accountants recorded revenue when they reduced the department's allowance for doubtful accounts. State Accounting Policy requires that an expenditure be recorded when increasing the allowance for doubtful accounts. Expenditures should have been reduced if the allowance for doubtful accounts is decreased. The department procedure over-stated revenue and prior year expenditures by $248,937 in the General Fund.

4. Department accountants did not properly adjust accounts receivable and deferred revenue accounts to reflect the revenue earned during each fiscal year. Department personnel said these errors occurred because year-end accruals were not properly reversed in the following year. As a result, receivables from the federal government and prior year revenue were overstated by $584,654 in fiscal year 1987-88 in the Special Revenue Fund. In fiscal year 1988-89, the receivable from the federal government and deferred revenue were overstated by $7,458,975.

5. The department did not properly account for Medicaid (CFDA #13.714) costs disallowed by the federal government in fiscal year 1988-89. Although the department has not been billed by the federal government for the final settlement amount, the department has lost its appeal of the disallowance. Generally accepted accounting principles require that contingent liabilities be recorded in the financial records when the likelihood of an unfavorable outcome is probable. As a result of the disallowance, the department should have recorded a direct entry to fund balance and it should have increased liabilities by $315,408, respectively, in the General Fund since the General Fund is liable for the disallowed federal costs.

6. SRS contracts with the Department of Health and Environmental Sciences (DHES) to perform certification reviews of medical facilities participating in the Medicaid program. The department receives Medicaid Certification grant money from the federal government and transfers the funds to DHES, recording revenue and expenditures, respectively for these transactions. DHES records revenue and expenditures when it receives and disburses these funds. As a result, expenditures and revenue are recorded twice on the state's accounting records. Special Revenue Fund revenue and expenditures were overstated on a statewide basis by $234,827 and $229,543 in fiscal years 1987-88 and 1988-89, respectively.

   Generally accepted accounting principles, require that the transactions between SRS and DHES related to Medicaid certification be recorded as transfers. A department accountant said that SRS recorded the payments to DHES as benefit expenditures because the

department budgeted the payments in the benefits expenditure object.

The following schedule summarizes the effect that the accounting errors identified above had on the SRS accounting records during the audit period.

Schedule of Effect for the Accounting Issues

Account	General Fund	Special Revenue Fund
Revenue	$ 27,317	$ (499,669)
Expenditures	(221,620)	(499,669)
Prior Year Expenditures	284,937	
Prior Year Revenue	584,654	
Fund Balance	315,408	584,654
Due to Federal Government	(315,408)	
Receivable from Federal Government		8,043,629
Deferred Revenue		7,458,975

*Overstatements (understatements)

Recommendation B12-16

We recommend the department properly record transactions in compliance with state law.

Response B12-16
Concur. The Department concurs transactions should be recorded in compliance with state law.

It is the Departments contention that instances number 1 and 2 describe pass-through monies that are being collected for the benefit of another and do not represent expenditures of the Department or the State.

The Department concurs with the recommendation in instance #3.

The Department concurs with the recommendation in instance #4. This will be corrected when the analysis of the fund balance is completed in July 1990.

The Department concurs with the instance #5 recommendation. When the final dollar amount is determined, July 1990, an entry will be made to the Federal Special Revenue Fund and to the General Fund.

The Department concurs with the recommendation set forth in instance #6. Beginning in state fiscal year 1989-90 DHES has their own letter of credit to draw federal funds for Medicaid certification.

B12-17.
Statewide Indirect Costs

The department has not recorded all statewide cost allocation plan (SWCAP) cost reimbursements in the General Fund as required by state policy. State accounting policy requires that all agencies determine the SWCAP recovery amount and move that amount into the General Fund. The purpose of the state policy is to ensure the General Fund is reimbursed for its share of indirect costs which are allocable to federal programs.

According to allocation worksheets prepared by the department, General Fund SWCAP cost recoveries should have been $12,326 and $8,360 more in fiscal years 1987-88 and 1988-89, respectively, than the General Fund received. A department official said the department did not transfer SWCAP reimbursements to the General Fund for two grants because the department had expended up to the federal limit for administration for these grants (CFDA #13.667 and #10.568). In such cases, additional administrative costs charged to these grants would be unallowable and the costs would be paid by the General Fund.

By spending the SWCAP reimbursement out of the Special Revenue Fund to offset General Fund expenditures the department is misrepresenting the actual General Fund support for federal programs on the state's financial records. The department is overstating expenditures in the Special Revenue Fund and understating expenditures in the General Fund. At the end of fiscal years 1987-88 and 1988-89, the department had sufficient appropriation authority to pay its program expenditures from the General Fund. The department could have transferred SWCAP reimbursements to the General Fund as required by state policy.

We made a similar recommendation in the last audit. The department did not fully implement the recommendation, but did increase the number of grants for which SWCAP payments were made to the General Fund.

Recommendation B12-17

We recommend the department transfer $20,686 in statewide cost allocation plan reimbursements to the General Fund as required by state policy.

Response B12-17

Do not Concur. The Department believes, as it has in the past, that it has complied with the state policy (MM 2-88-2) and statute (Section 17-3-111, MCA)---"the agency shall endeavor, to the fullest extent possible, to recover indirect costs from federal assistance programs".

When the Legislature appropriates federal funds to the Department, including block grant funds and capped federal grants, to be used for direct administrative costs and client benefits, those sources of funds are not available for indirect cost recovery. Therefore, the Department has transferred recoverable SWCAP costs to the General Fund.

The Legislature appropriates funds from the Special Revenue Fund for SWCAP recovery transfers, but provides no appropriation to any State agency from the General Fund to transfer to the General Fund for unrecoverable SWCAP costs.

B12-18. Contracted Services

The department contracts for certain services with outside vendors. Of 20 contract files we examined, 6 did not have proof of workers' compensation coverage as required by state law. State policy requires agencies to obtain proof of insurance from independent contractors retained by the agencies. Proof of insurance documents that the department does not bear the risk of liability for benefits in the event the contractor is injured while working on the state contract.

All the files without documentation of contractor coverage were from one division in the department. Developmental Disabilities Division management said that they were not aware the contractors should provide proof of workers' compensation coverage. The division uses Social Services Block Grant (CFDA #13.667) funds to pay some of these contracts.

Recommendation B12-18

We recommend the department ensure contractors furnish proof of Workers' Compensation Insurance coverage.

Response B12-18
Concur. The Developmental Disabilities Division agrees to have proof of Worker's Compensation Coverage provided by the corporations with which the Division contracts for services.

This proof of coverage will be requested of all corporations prior to July 1, 1990. In the next contracting cycle, contract language will be changed to include submission of this proof prior to the signing of a contract.

B13-1.
Expenditure Accruals

The council did not properly accrue expenditures at the end of fiscal years 1987-88 and 1988-89. State policy requires that agencies accrue expenditures only for valid obligations. According to state policy a valid obligation exists when a liability is incurred. State policy also allows agencies to accrue expenditures for goods ordered as of fiscal year-end, if a purchase order is issued prior to fiscal year-end. Agency's may accrue expenditures for contracts if the contract is signed by the contracting parties prior to fiscal year-end. Fifteen of sixteen expenditure accruals we tested at the council were not for valid obligations. The transactions tested were primarily funded with money from the National Endowment for the Arts (NEA) (CFDA #45.003 and #45.007).

The 15 errors related to accrual transactions recorded for printing services and contracts with artists. The accrued expenditures for printing were not supported by a purchase order as required by state policy. The purchase orders were obtained by the council in the following fiscal year. The contracts with the artists were not signed until after the end of the fiscal year. Because no liability exists until a contract is signed by the contracting parties these accrued expenditures should not have been recorded until the following year. A council employee changed some contracts to make it appear the documents were executed before the June 30, 1989 deadline for accrual. On copies of four contracts provided to us and used to support the SBAS transactions the date of the contract had been altered from July 7, 1989 to June 30, 1989. The employee who changed the contract date said that due to an error the contracts were dated the 7th of July rather than the 30th of June. The employee said she did not know when the contracts were signed by the contracting parties.

By improperly accruing expenditures the council overstated accrued expenditures charged against its appropriation. This issue was also noted in the prior two audits of the council. The council concurred with the recommendation in each audit but

did not implement it. The schedule below summarizes the amount of improper accruals reported in audit reports for the past six fiscal years.

Fiscal Year	Improperly Accrued Expenditures
1983-84	$17,654
1984-85	1,152
1985-86	4,150
1986-87	9,137
1987-88	35,411
1988-89	15,566

Because the accruals tested were for services to be received after the end of the fiscal year, the transactions are recorded as encumbrances rather than expenditures on the state's financial statements and the federal financial reports. Council personnel indicated they believed the accruals were for valid obligations because they related to projects approved by the NEA in the fiscal year they accrued the expenditures.

Recommendation B13-1

We recommend the council accrue expenditures only for valid obligations.

Response B13-1

We concur, but find ourselves in a dilemma in regards to the $65,416 in federal funds, we believe our constituents would have lost if those funds had not been accrued by fiscal year end. We are obligated to expend the money wisely, and thereby, not hastily. Since the grant fiscal year is the same as the state fiscal year, we are unable to receive continuing authority from the state; though the NEA has granted us extensions every year since the first. We would be unable to receive a budget amendment, since the funds were available for legislative consideration. The comment that refers to changing dates on contracts

sounds most sinister; however, it was simply a pencilled-in request for correction of an inaccurate date. A few contracts were not re-typed and went out with a pencilled changed date. We are working diligently with the budget office and other agencies which receive federal funds to comply with this state requirement without losing these funds.

Contemplated corrective action: Further research on how to comply with this recommendation without losing federal dollars. If this is impossible, we will revert unexpended federal money to the NEA. At this fiscal year end we will only accrue items for which there is an executed purchase order or a signed contract dated before June 30.

Timetable for implementation: Fiscal year end 1990.

B13-2.
Travel

The council did not reimburse employees and council members for travel expenses in accordance with state laws. State law requires all lodging reimbursements be supported by an appropriate receipt. It also outlines the number of hours a person must be in travel status to be eligible for meal reimbursement.

The council reimbursed an employee for one night's lodging which was not supported by a receipt and reimbursed a council member for a meal for which they were not eligible. We also noted three instances where the council paid for meals for employees or council members and also reimbursed them for the meals. By reimbursing the employee or council member and also paying for the meal, the state pays for the meals twice.

The five errors discussed above amounted to less than $150. These expenditures were paid from federal funds. Therefore, we are required by federal regulation to question these costs (Basic State Grant CFDA #45.003). Council personnel indicated they should not have reimbursed the employee for the unreceipted lodging. They also indicated the other errors should have been caught during the review process but were overlooked. The council should pay travel expenses in accordance

with state law and should not pay for meals for employees or council members and also reimburse them for the meals.

Recommendation B13-2

We recommend the council pay travel expenses in compliance with state law.

Response B13-2
We concur. Contemplated corrective action: The council will not reimburse for lodging unless supported by a receipt. Staff have been instructed to not pay for meals of others who are eligible to receive state meal reimbursement. We will carefully review travel claims for staff and council when meals are being provided.

Timetable for implementation: Immediately.

B13-3. Federal Cash Management

During fiscal years 1987-88 and 1988-89, the council received two grants from the National Endowment for the Arts (NEA): the Basic State Grant (BSG) (CFDA #45.007), and the Artists in the Schools Program (AIS) (CFDA #45.003). The council sub-grants these NEA funds to nonprofit organizations and artists. The council uses the BSG grant to pay a portion of its operating costs. Both grants require the grantee or subgrantee to match federal funds at least dollar-for-dollar. The council receives money from the NEA through letter-of-credit drawdowns.

During the audit period council personnel drew $50,000 from the NEA every four to six weeks. Office of Management and Budget (OMB) "Circular A-102, Attachment G" prescribes standards for federal grant cash management systems. These standards require that the council provide procedures to minimize the time elapsing between when cash is received by the state and when it is disbursed. Noncompliance with the federal standards may result in the loss of federal funds.

We noted four instances in fiscal year 1988-89 where the council's balance of federal cash on hand exceeded a 30 day supply. For example, the council's accounting records indicate the council had $57,765 of federal cash deposited with the state treasury at December 31, 1988, while the combined January and February 1989 expenditures were less than $37,000. This indicates the council is maintaining cash balances higher than necessary to meet its needs.

The system of letter-of-credit drawdowns has been established by the federal government to reduce the time between request and receipt of federal cash. Normally the state receives cash within one or two days of its request. The council uses the federal cash to pay for payroll and operating expenditures and for subgrants allowed under its agreement with the NEA. If the council would project its needs for cash every two weeks just prior to meeting its payroll, the council could significantly reduce excess federal cash.

Council personnel indicated they processed the cash draws for $50,000 every four to six weeks because of the time involved in processing the letter-of-credit drawdowns and because they believed the NEA had a minimum draw amount of $50,000. Council personnel were unable to provide support documentation confirming that the NEA has a $50,000 minimum drawdown requirement. However, they did obtain new information indicating there was a $5,000 minimum draw amount. Council personnel indicated it takes approximately one hour to process each letter-of-credit drawdown. We believe the council could process drawdowns more frequently without significantly increasing their workload. Because the council receives the money from the NEA the day after they process the proper request, we believe the council should estimate the money needed and prepare cash draws on a bi-weekly basis or as needed.

Recommendation B13-3

We recommend the council establish procedures to minimize the time between the receipt and disbursement of federal cash.

Response B13-3

We concur. Contemplated corrective action: We have begun ordering federal funds in the amounts immediately needed but not less than the NEA's minimum of $5,000. Since the audit report was submitted, we have received word from the NEA that the Treasury has eliminated all letter of credit payments to NEA subgrantees as of June 25, 1990. We will now be required to order 30 days of cash 3-4 weeks in advance.

Timetable for implementation: Immediately.

B14-1. Property Control

State policy required state agencies to record all property and equipment in excess of $200 on the Property Accountability Management System (PAMS). Effective July 1, 1988 (fiscal year 1988-89) the capitalization limit was raised to $1,000 but agencies could choose to maintain a lower capitalization limit. The department chose to retain the $200 limit. Federal regulations also require that equipment be identified and accounted for in accordance with state policy. The department purchased equipment with federal funds from the Environmental Protection Agency Pesticide Enforcement Grant (CFDA #66.700).

The department did not recorded approximately $7,200 and $30,100 of equipment purchased with state and federal funds on PAMS for fiscal years 1987-88 and 1988-89, respectively. Even though the department has a policy governing the recording of equipment, department personnel indicated that they cannot find the time to ensure all equipment items are properly recorded on the property system. The department's policy states that divisions submitting equipment purchases over $200 to Centralized Services must also submit a PAMS property update form. If the department enforced its policy, the time needed to maintain a current property record is minimal.

Recommendation B14-1

We recommend the department follow established procedures to ensure all equipment is recorded on the Property Accountability Management System.

Response B14-1

Amounts referenced in the audit report have been properly recorded and updated on the Property Accountability Management System. In addition, the department has strengthened the enforcement of department policy by processing payments and PAMS forms simultaneously.

Federal Issues
State Auditor's Office

B15-1.
Forest Reserve Grant

The State Auditor's Office receives federal funds from the U.S. Department of Agriculture, Forest Service. The federal government sends the money to the Office for Montana's share of earnings from national forests located within the state's boundaries. The money received is to be allocated, as directed by the federal government, to counties entitled to a portion of the receipts. The counties' use of the funds is limited by section 17-3-213, MCA.

B15-1a.
Monitoring System

The Single Audit Act of 1984, implemented by Office of Management and Budget (OMB) Circular A-128, requires a grantee to establish a monitoring system for subrecipients of federal assistance. Thus, the State Auditor's Office is required to have a monitoring system for the counties receiving forest reserve money (CFDA #10.665). In addition, the grant agreement the State Auditor's Office has with the federal government requires the Office to ensure that funds are used for the benefit of public schools and roads, as set forth in state law.

During our previous audit of the State Auditor's Office, we expressed concern that the Office did not have a monitoring system for the counties. The Office responded that it would have a system in place by December 1986. However, we found that the Office still did not have a monitoring system as of December 1988.

The Department of Commerce, Local Government Services has the responsibility for ensuring all counties are audited. The Office receives Local Government Services' audit reports for counties that receive forest reserve money. The audit reports can be used to determine if the counties spent the forest reserve money in accordance with state law and the federal grant agreement. The Office should establish procedures to verify that the audit reports it receives comply with the requirements of OMB Circular A-128 and act on the audit reports containing issues that could affect the counties use of forest reserve money.

<u>**Recommendation B15-1a**</u>

We recommend the State Auditor's Office develop a subrecipient monitoring system for federal moneys in accordance with OMB Circular A-128.

<u>Response B15-1a</u>
The State Auditor's Office concurs with this recommendation. The office has already begun developing a subrecipient monitoring system for counties receiving forest reserve money. The system will be fully implemented by the beginning of fiscal year 1991.

B15-1b.
Forest Reserve Investment Earnings

The U.S. Department of Agriculture (USDA) distributes federal forest reserve money (CFDA #10.665) in two payments which are received by the State Auditor around October and December of each year. State law requires the State Auditor to direct the distribution of all forest reserve money and interest earned on that money to Montana counties within 30 days after receiving full payment.

Fiscal Years 1987 and 1988

The State Auditor's Office received and held the first fiscal 1987-88 payment of $4,819,230 for 105 days, but invested it for only 48 days. The second 1988 payment of $1,581,874 was held for 30 days but only invested for 18 days. During the time the forest reserve money was not invested by the State Auditor's Office for the benefit of the fund, it remained in the Treasurer's Fund. Using the Treasurer's Fund investment yield rate for fiscal year 1987-88, we estimate interest earned on forest reserve moneys of $54,887 was credited to the state General Fund rather than the Federal Forest Reserve Account. Consequently, $54,887 was not distributed to counties as required by state law. We also reviewed the receipt, investment, and distribution of forest reserve money to counties in fiscal year 1986-87 and estimate $27,469 of investment earnings accrued to the General Fund rather than being distributed to counties.

Fiscal Year 1989

During our audit of the federal forest reserve funds for fiscal year 1988-89, we found the State Auditor's Office held the final payment from the USDA 44 days, but invested it for only 34 days. During the other 10 days the money remained in the Treasurer's Fund, where any investment earnings go to the General Fund. We calculated the General Fund received approximately $14,866 from investments these 10 days using the fiscal year 1988-89 treasury rate. State Auditor's Office personnel explained the initial delay in distributing fiscal year 1988-89 federal forest reserve funds to the counties was due to the holiday season and a shortage of staff. A subsequent delay occurred when the administrator of the Central Administration Division sold the investments; then realized the State Auditor's Office did not have sufficient budget authority to make a complete distribution to the counties and obtained a budget amendment for the additional authority needed.

The Board of Investments (BOI) invests the money for the Treasurer's Fund. Since investment earnings were credited to the General Fund, the Office should work with BOI to determine the exact amount of earnings that accrued to the General Fund for fiscal years 1986-87, 1987-88, and 1988-89. Once the amounts have been determined, the State Auditor's Office should request that BOI transfer the money out of the General Fund and credit it to the Federal Forest Reserve Account so the Office can distribute the interest earnings to the counties in accordance with state law.

Recommendation B15-1b

We recommend the State Auditor's Office:

A. Work with BOI to determine the dollar amount of interest earnings that should have been distributed to the counties in fiscal years 1986-87, 1987-88, and 1988-89.

B. Transfer interest earned on federal forest reserve money to the Federal Forest Reserve Account.

C. Distribute the interest earned on federal forest reserve money to the counties in accordance with state law.

D. Invest forest reserve money from the time received until distributed.

Response B15-1b

A. The State Auditor's Office concurs with this recommendation. The office plans to work with the BOI to determine the exact amount of interest earnings that should have been distributed in the fiscal years 1986-87, 1987-88, 1988-89.

B. The State Auditor's Office concurs with this recommendation. Once the interest earnings have been determined for the fiscal years 1986-87, 1987-88, and 1988-89, the office will see that the earnings are transferred to the Federal Forest Reserve Account.

C. The State Auditor's Office concurs with this recommendation. After the interest earnings for the fiscal years 1986-87, 1987-88, and 1988-89 are transferred to the Federal Forest Reserve Account, the office will distribute the interest earnings to the

counties in accordance with state law. The office will make every attempt to distribute the interest earnings in fiscal year 1991.

D. The State Auditor's Office partially concurs with this recommendation. The office agrees that the forest reserve money should be invested for the maximum possible time period, but the office feels that there has to be some turnaround time to sell the S.T.I.P. investment through the BOI, determine final payment amounts, prepare state warrants, prepare notification letters, and mail the payments. The office feels that a ten-day period for these tasks is not unreasonable.

B16-1. Accrual of Federal Funds

The department's Energy Division awards grants to individuals and organizations for projects that research, develop, or demonstrate energy conservation. Federal money funds these grants in whole or in part.

At fiscal year-end 1987-88, the department's Centralized Services Division improperly accrued $34,508 of Biomass Utilization and Cogeneration (BUC) funds (CFDA #81.079) for a grant project. The department's Energy Division personnel had determined this project would not receive those particular federal funds. Subsequently, in August 1988, the Energy Division entered into a grant agreement with a new grantee, and committed the same BUC funds to the new project, thus committing the same funds twice. In December 1988, Centralized Services cancelled the expenditure accrual for the original grant. Although the department made the proper correcting entries in fiscal year 1988-89, this situation resulted in a $34,508 overstatement of Special Revenue Fund expenditures for fiscal year 1987-88.

State accounting policy requires that a valid obligation exist before an expenditure is accrued. Because at the time of accrual the Energy Division had made the decision to commit these funds to another grant, for which a contract was not yet signed, a valid obligation did not exist and the accrual should not have been made. The Energy Division and the Centralized Services Division should develop a more effective process to communicate which grant's expenditures should be accrued at fiscal year-end.

Recommendation B16-1

We recommend the department accrue expenditures when a valid obligation exists, In accordance with state accounting policy.

Response B16-1

The department concurs with the recommendation. As stated in the auditor's report this error has already been corrected.

B16-2. Annual Reports

The state of Montana receives federal funds as the result of the settlement of various lawsuits with petroleum companies. The Department of Natural Resources and Conservation administers the programs funded by these Petroleum Violation Escrow (CFDA #15.999) moneys. Federal regulations require the department to prepare a report each year describing the projects and expenditures financed with Petroleum Violation Escrow moneys. The report is due 90 days after the end of the state fiscal year, or by September 28. The department submitted its fiscal year 1987-88 report to the U.S. Department of Energy in May 1989 and, as of April 1990, has not submitted its fiscal year 1988-89 report. Department personnel stated preparation of the annual reports has been delayed because they needed more time to gather information from other state agencies concerning their expenditure of Petroleum Violation Escrow moneys.

Recommendation B16-2

We recommend the department prepare and submit the annual Petroleum Violation Escrow expenditure report within the time required by federal regulations.

Response B16-2

The department concurs with the report. The department will establish procedures to ensure the annual Petroleum Violation Escrow expenditure report is prepared in a more timely manner.

Federal Issues
Office of Public Instruction

B17-1.
ECIA Chapter II
Federal Funds Supplant
General Fund

Federal regulations require at least 80 percent of Education Consolidation and Improvement Act (ECIA) Chapter II Block Grant (CFDA #84.151) funds be distributed to schools which submit applications showing allocation of funds between basic skills development, educational improvement and support services, and special projects. The balance of the grant may be used for administration. The amount of money expended under the block grant during fiscal year 1987-88 was $2,229,872 of which $410,669 was related to administration. Public Law 97-35 establishes the ECIA Chapter II Block Grant. It limits the use of ECIA Chapter II funds to activities which supplement and increase the level of funds that would otherwise have been available in the absence of federal funds and prohibits the use of funds for performing functions mandated by state law. The Office of Public Instruction's (OPI's) data processing department is entirely funded by ECIA Chapter II Block Grant funds. The office processes reports which support major state legislated functions such as the foundation program, transportation, and teacher certification. In supporting these programs with Block Grant funds, OPI is supplanting state effort with federal funds.

In fiscal year 1987-88, OPI personnel estimated 50 percent of data processing activities or approximately $108,436, were not related to ECIA. We question the allowability of these costs. OPI could lose ECIA Chapter II Block Grant funds if the supplanting condition is not corrected. This was a prior audit recommendation with which OPI concurred. OPI personnel indicated they have reorganized the funding for data processing beginning in fiscal year 1988-89 in order to correct this situation.

Recommendation B17-1

We recommend OPI charge only allowable costs to the ECIA Chapter II Block Grant.

Response B17-1
We concur. Current Status - This recommendation has been implemented. Data processing costs in FY90 are paid 100% General Fund.

B17-2.
School Lunch Matching

OPI did not meet the required state matching expenditures in the school lunch program (CFDA #10.555) in fiscal year 1987-88. State expenditures fell $377 short of meeting the required $594,751. OPI personnel indicated expenditures are accrued near year-end based on estimates. When the actual invoices were received the expenditures were less than estimated and thus expenditures fell short. The amount was believed to be too small to redistribute.

The remaining match could have been met by charging OPI operating costs for the school lunch program, such as telephone charges related to food distribution, to the match appropriation.

Recommendation B17-2

We recommend OPI establish procedures to ensure school lunch matching requirements are met.

Response B17-2
We concur. Current Status - Final distributions are not made until all invoices are received.

B17-3.
Electronic Data Processing Controls

OPI operates a minicomputer, a microcomputer network and several independent microcomputers to process financial and non-financial information. The primary uses of the minicomputer are to:

- process information on the foundation program and generate various reports used by OPI personnel to administer the program;

- process information on grant reports received from school districts and generate reports used by OPI grants accountants; and

- process information and generate reports on teacher certification.

The microcomputer network is going to be used to process federal grant accounting information and will directly input information on the accounting records in fiscal year 1988-89. The independent microcomputers are used in a variety of OPI applications which affect federal financial assistance programs from the U.S. Departments of Education, Agriculture, Labor, and Interior.

As part of our audit we reviewed internal controls, both accounting and administrative, over significant financial operations. Although we did not identify any electronic data processing (EDP) controls key to the financial operations of OPI, we did identify some control weaknesses in the EDP general controls. EDP general controls are those controls that relate to all or many computerized activities. These controls include controls that limit the use of and changes to data maintained on computer files. General controls also include controls that safeguard physical safety of computer hardware and software. The weaknesses we noted related to:

- segregation of EDP duties;

- restriction of physical access to the computer; and

- documentation of disaster recovery plans.

Segregation of duties is a control that limits the ability of one person to perpetrate errors or irregularities and then conceal those errors or irregularities. We noted that although OPI's EDP staff numbers seven individuals, several key functions were

performed by one or two individuals. For example, one individual performs primary duties of:

- security officer;
- systems analysis;
- programming, development and maintenance;
- documentation and backup procedures; and
- minicomputer systems maintenance.

The same individual has secondary responsibility for backup input/output controller and microcomputer network design and installation. OPI personnel indicated that lack of segregation of duties was the result of not having a staff large enough to allow one individual to perform one function and that some duplication is inevitable. While this is true, OPI could better segregate duties with the current staff. To better segregate the duties of the individual in our example above, OPI could:

- assign security officer duties to either someone else in the EDP section with less responsibility for programming and systems analysis or to someone at OPI outside the EDP section;

- implement policies and procedures to ensure staff with both programming and systems analysis duties do not serve in the systems analysis capacity in areas where they have programming responsibility or vice versa; and

- implement procedures to ensure minicomputer systems maintenance is approved and reviewed by the manager.

Since these suggestions and other changes required to ensure segregation of duties can be accomplished by redistributing assignments and implementing policies and procedures with existing staff, the cost of implementation will not be significant.

Physical access to the room containing the minicomputer should be restricted to reduce the risk of unauthorized activity or vandalism and destruction of EDP hardware. We noted the EDP facility does not have fire or burglar alarm protection. OPI personnel indicated no major losses have occurred to this point as a result of not having fire or burglar alarms. The lack of loss

to fire or break-in in the past does not eliminate the possibility of loss in the future. We also noted programmer analysts have keys for after hours access to the computer room when they should not need access to the computer room at all. OPI personnel indicated programmer analysts needed access to the computer room to retrieve printouts when working after hours. The printer and computer can be physically separated to eliminate the need for after hours access to the computer room by programmer analysts.

A well documented disaster recovery plan can reduce the loss when EDP hardware or software are damaged or destroyed. State policy requires "A disaster contingency process should be developed to document alternative means of operating." OPI does not have a documented disaster recovery plan. OPI personnel indicated staff had been assigned the task of documenting a disaster recovery plan but that they are busy and it had been assigned a low priority.

The weaknesses identified above did not impact our ability to audit OPI's accounting records in the current audit. However, in fiscal year 1988-89, OPI implemented an accounting system on a microcomputer network. This system will directly input information to OPI accounting records. The integrity of this system is impacted by the controls over EDP operations at OPI. The foundation of EDP controls over any system is a good system of EDP general controls. EDP general controls provide assurance:

- information was processed consistently during a particular period of time;
- changes to data and/or software were properly authorized;
- errors or irregularities will be detected in a timely manner; and
- assets, hardware and software, are adequately safeguarded.

If the weaknesses noted above are not corrected, OPI's future ability to represent that financial records are accurate and complete may be adversely affected.

Recommendation B17-3

We recommend OPI:

A. Adequately segregate the duties of the EDP staff.

B. Implement procedures to adequately safeguard the minicomputer facility.

C. Adequately document a disaster recovery plan.

Response B17-3

A. We concur. Current Status - We have effected changes in the data processing section to resolve the segregation of duties issue.

B. We concur. Current status - The computer room door locks were changed and only two keys exist to enter the facility. One is kept by the Honeywell I/O controller. The other key is kept by her supervisor who is also the Honeywell Computer Facility Security Officer. We determined that moving the Honeywell printer would present some additional problems and we have not initiated that move to date. Programmers will request their printouts from the I/O controller until those problems are resolved. We have established a network printing room next to the computer room and are providing network printing services from that room. The file server is adequately protected in the computer room.

An estimate was obtained on the cost of providing burglar alarms and security service in 1987 and it was estimated to be $24,300. We have not updated that

estimate recently but intend to do so in the near future. Some of the work we are currently performing on the local area network system will have an effect on security provisions and costs throughout the office.

C. We concur. Current Status - A disaster recovery plan for the Honeywell system was completed in January of 1989. That plan is already in need of updating due to changes in staff and equipment. Staff will be assigned to update the disaster recovery plan and make modifications to the plan to include the wide-area network.

B18-1. Personal Service Charges

Certain management personnel in the department are improperly allocating time to state and federal programs. State policy and federal regulations require the salaries of employees chargeable to more than one grant or state program be allocated based on an equitable distribution of time and effort.

We identified three management personnel at the department who should have charged approximately 845 hours to the Superfund (CFDA #66.802) program during federal fiscal year 1987-88. Instead these people charged their time to other department programs. We found that during federal fiscal year 1987-88 these three employees charged only four hours to the Superfund program. The employees estimate they may have spent as much as 10 to 25 percent of their time on Superfund. Based upon our review of personal service projections on the Superfund cooperative agreements, we estimate that other programs may have paid up to $17,000 of personal service expenditures and benefits that could have been charged to Superfund.

Based upon discussions with Environmental Protection Agency officials and review of the Superfund cooperative agreements, it would have been allowable for these management personnel to track their time for each Superfund activity and charge the Superfund program for the time spent. Department officials indicate a system is in place to ensure actual time is charged to all federal programs. However, due to misunderstandings, a few personnel were not following the established policies. The department should consider reviewing any available time records kept by the employees, such as monthly log books or calendars to recalculate the actual time chargeable to the Superfund program. The actual time spent on Superfund should be used to correct the payroll records and applicable federal reports.

Recommendation B18-1

We recommend the department:

A. Correct the underpayment of personal service charges to the Superfund program for fiscal year 1987-88.

B. Ensure employees properly charge federal programs for the actual time spent on the program.

Response B18-1

A. Do not concur. Federal Circular A-87 states that payrolls must be supported by time and attendance or equivalent records for individual employees. Salaries and wages of employees chargeable to more than one grant program or other cost objective will be supported by appropriate time distribution records. The method used should produce an equitable distribution of time and effort. It would be impossible at this time to go back to fiscal year 1987-88 and obtain supported time and attendance records for work done on the superfund project.

B. Concur. Department employees have been informed of the requirements to keep adequate attendance records and supervisors have been informed of their responsibility to certify that payroll time sheets are accurate.

B18-2. Federal Financial Status Reports

During our prior audit of the Department of Health and Environmental Sciences for fiscal years 1986-87 and 1987-88, we identified errors on federal financial status reports (FSRs) for the Superfund (CFDA #66.802), and the Women, Infants and Children (WIC) programs (CFDA #10.557). The department concurred with, but did not fully implement, our recommendation to ensure amounts reported on the federal financial status reports are accurate and comply with federal regulations.

During the current audit of the department, for fiscal years 1988-89 and 1989-90, we identified errors in three of the four FSRs tested for the Child Nutrition Program (CFDA #10.558) and the Superfund program. In addition, we identified misstatements on the federal report for the Child Care Food Program report (FNS-44). Federal regulations require that federal financial status reports and FNS-44 reports submitted to the federal government be accurate and supported by the department's accounting records.

Child Nutrition

We reviewed the Child Nutrition program FSR for federal fiscal year 1988-89. We noted the total cumulative amount of cash available did not tie to the Child Nutrition records (FNS 374-1 - Notice of Revised Program Limitations). The FSR overstated the categorical authorizations by $51,000 for meal service, $7,000 for sponsor administration, $5,000 for audit, and $1,000 for cash for commodities. In addition, total outlays include a prior period adjustment of $1,364 which relates to a previous grant which has been closed out.

Two of the three FNS-44 reports reviewed in federal fiscal year 1989 did not tie to the department's Child Nutrition records. The number of outlets for head start centers was overstated by 56 on the October 1988 report.

Superfund

We reviewed two FSRs in the Superfund program and found errors on both. In reviewing the FSR for Superfund cooperative agreements, we identified total outlays for the report period ending March 31, 1989 are overstated by $73. In addition, the nonfederal outlays (the 5 percent state match) cannot be tied to the Statewide Budgeting and Accounting System (SBAS). The amount recorded on the FSR is $6,694 and the amount per SBAS is $5,990.

We reviewed the FSR for the report period ending March 31, 1989 for the Clark Fork Superfund site. The department did not

correctly report the indirect costs (IDC) for the report period. Indirect costs are overstated by $2,201. The indirect cost base (personal service expenditures) for the report period is overstated by $17,328. Department personnel indicated the IDC amounts reported on the FSR were based on the project period rather than the report period of April 1, 1988 through March 31, 1989. The FSR preparation instructions require the IDC base, rate and amount charged be reported for the report period.

The department did not correctly report amounts relating to the Silver Bow cooperative agreement on the FSR dated October 28, 1988. The department reported $2,055,663 of current period expenditures on the FSR when the accounting records reported $2,020,592 for the same time period. Another line item on the FSR also did not agree with the accounting records. Unpaid obligations were reported as $979,334, while the amount on the accounting records was $956,782.

The department could not find the documentation supporting the FSR calculations. When the department attempted to reconstruct the calculation of the FSR amounts, it discovered that errors had been made. Department officials explained that the Silver Bow FSR was an interim report and the errors will be corrected on the next FSR.

Women, Infants, and Children

The department improperly included encumbrances with expenditures on the WIC program final financial status report submitted for federal fiscal year 1986-87. Encumbrances are used to reserve a portion of an appropriation for anticipated expenditures. Because an encumbrance is not an expenditure, it should not be included with expenditures on final financial status reports (FSR).

Federal regulations in effect at the time the report was prepared required that unpaid obligations (encumbrances) be excluded from final FSRs. The department included $13,472 of encumbrances on the 1986-87 final report. Consequently, the expenditures reported on the final report to USDA are overstated by

the amount indicated above. Department personnel indicated they normally include encumbrances as expenditures on final reports and then later adjust the final report.

Because of the concerns noted on the WIC FSR, we examined FSRs for other federal grants completed by the department. We found that the Child Nutrition (CFDA #10.558) final FSR for the federal fiscal year 1986-87 included $1,160 of encumbrances as expenditures.

We question the allowability of the $14,632 ($13,472 + $1,160) of expenditures reported on federal FSRs for the WIC and Child Nutrition programs.

Department personnel indicated the misstatements were due to human error and oversight in preparing the reports. The department should establish a system for review and recalculation of the federal reports to ensure the reports are accurate.

Recommendation B18-2

We recommend the department establish a system to prepare and provide supported and accurate reports to the federal government in accordance with federal regulations.

Response B18-2

Concur. A system has been put in place at the program level to assure that the FNS-44 reports and agency reports are accurate. All federal financial status reports will be reviewed by at least one person other than the preparer before the reports are sent to the federal agencies.

B18-3. Subrecipient Monitoring

The department subgrants federal financial assistance moneys it receives from the U.S. Department of Health and Human Services and the Environmental Protection Agency. The department does not have an adequate system to monitor local governments that receive federal financial assistance through the department. Federal regulations require the department to determine whether local governments, which receive subgrants of federal moneys through the department, have met the audit requirements of OMB Circular A-128. The regulation also requires the department to ensure that appropriate corrective action is taken by the local government within six months after it receives the audit report.

The department personnel who are responsible for monitoring subrecipient audit reports do not know when local government audit reports are due to be received and there is no system established to ensure appropriate corrective action is taken within six months for instances of noncompliance with federal regulations. The following two sections discuss our specific concerns.

Receipt of Subrecipient Audit Reports

Federal regulations require the department to ensure it receives subrecipient audit reports within one year after the end of the audit period. The department received only 28 percent (9 of 32) of the subrecipient audit reports we tested in a timely manner. The department did not date stamp five of the thirty-two reports tested when received so we could not determine whether they were received in a timely manner. The contracts between the department and the local governments require that the local government audit reports meet the requirements of OMB Circular A-128. The department should enforce the contract language by following up with a letter when reports are not received within one year after the end of the audit period. The department should also document the local government audit schedule so personnel responsible for monitoring subrecipients know when audit reports are due.

Corrective Action on Federal Compliance Issues

The department does not review audit reports to identify federal compliance issues in a timely manner. It also does not have a system to ensure that appropriate corrective action is taken within six months after it receives the audit report, as required by OMB Circular A-128. Three of the thirteen subrecipient audit reports we tested were not even reviewed by the department within six months after it received the reports. These reports were received by the department in August 1989 and were not reviewed by department personnel as of April 10, 1990. In another 4 of the 13 audit reports tested, which had been in the department's possession for longer than six months, we noted the department did not follow up to ensure appropriate corrective action was taken by the subrecipient for recommendations involving noncompliance with federal laws and regulations. The department should establish an audit resolution schedule to ensure audit reports are reviewed in a timely manner, and to help ensure issues of noncompliance with federal regulations are resolved within the required six months.

Department officials indicated that due to a shortage of staff the Centralized Services Division has been unable to properly monitor subrecipient audits. The officials indicated the internal auditor's time has been occupied with other department priorities.

Recommendation B18-3

We recommend the department establish a system to ensure it:

A. Receives subrecipient audit reports in a timely manner.

B. Resolves issues of noncompliance with federal regulations within six months as required by federal regulations.

Response B18-3
Conditionally concur.

A. Since the audit work was performed in the department, we have obtained a schedule of the audits to be completed for the fiscal years ended June 30, 1989 and 1990 from the Montana Department of Commerce. Based on that schedule, we have prepared a control schedule to monitor the due dates of the audit reports, dates the audit reports were received, follow up action taken, and the date the audit report was closed.

B. We have implemented an automated tracking system to ensure that responses to noncompliance issues are resolved in accordance with federal regulations.

The Department of Health and Environmental Sciences takes exception to the portion of this recommendation that pertains to the timely receipt of the audit reports. The completion of county audit reports are the responsibility of the Montana Department of Commerce. (2-7-503 MCA) The current schedule obtained from Commerce indicates several audit reports that will be issued will not comply with the 1 year requirement of A-128.

We believe that this issue should be one that is addressed as a statewide issue, not one that only pertains to the Department of Health and Environmental Sciences. Other agencies such as Social & Rehabilitation Services, and Family Services also are required to review these audits.

B18-4. Handicapped Children Service

The department has not established rules for the Handicapped Children Service (HCS). Section 50-1-202(13), MCA, states that the department shall develop, adopt, and administer rules for the Handicapped Children Service. The rules should include standards for diagnosis, medical treatment, after-care services, and

eligibility. The state law requiring the department to adopt rules was enacted by the 1983 legislature. In addition, federal regulations require the department to have rules governing HCS. This program is funded by the Maternal and Child Health Block Grant (CFDA #13.994).

The HCS program provides for the medical evaluation, treatment, and financial assistance for families with children with handicapping medical conditions. It also assists with the cost of emergency transportation of pregnant women in labor. During our audit period, there were three different program directors for HCS. We noted inconsistent practices established by each program director regarding eligible services and reimbursement rates for medical expenses. Without established rules outlining allowable services, inconsistent practices could continue. Department officials were unable to explain why rules had not been established for the HCS program. The officials indicated the department has now initiated efforts to establish rules for the HCS program.

Recommendation B18-4

We recommend the department establish rules for the Handicapped Children Service in accordance with state and federal laws and regulations.

Recommendation B18-4

Concur. Rules have been submitted and scheduled for public hearing on June 6th. They will become effective on July 1, 1990.

B18-5. Emergency Medical Services Program

The department does not have a written plan of cooperation for the Emergency Medical Services (EMS) program. Section 50-6-104, MCA, requires the department to work with the Department of Justice and other interested state agencies to

develop a written a plan of cooperation. The purpose of a written plan is to ensure government effort is not duplicated. A portion of the EMS program is funded by the Preventative Health Block Grant (CFDA #13.991).

Department personnel in the Emergency Medical Services Bureau said they meet with Department of Justice personnel at least two or three times a year to discuss EMS. However, they have never developed a written plan of cooperation. Department officials indicated the department would prepare a plan as required by law.

Recommendation B18-5

We recommend the department develop a written plan of cooperation with other state agencies for the Emergency Medical Services program in compliance with state law.

Response B18-5

Conditionally concur. We have an agreement dated May 1, 1989. This appears to be a finding that is a State issue and has no effect on any federal funds or programs.

B18-6. Electronic Data Processing

Our audit identified several concerns related to electronic data processing (EDP) in the department. The EDP systems contain information for programs administered by the department. In addition to mainframe applications, the department operates a microcomputer network. We noted control weaknesses at the department for the following EDP issues. These control weaknesses could affect the following federal agencies that provide monetary assistance to the department: U.S. Department of Agriculture, U.S. Department of Health and Human Services, and the Environmental Protection Agency.

B18-6a.
Backup and Disaster Recovery

The department does not have a written and tested backup and recovery plan for the critical computer applications that run on the state's mainframe computer. Based upon a survey conducted by the Department of Administration Information Services Division (ISD), the Department of Health and Environmental Sciences identified eight mainframe applications it considers crucial to the payment of vital obligations or generation of vital state revenue. The computer applications identified as crucial are: 1) WIC Core Accounting; 2) WIC Certification; 3) Food and Consumer Safety Sanitation License; 4) Family Planning Client Information Reports; 5) Family Planning Allocation Formula; 6) Handicapped Children Services Budgeting and Accounting System; 7) Water Analysis Billing; and 8) Family Planning Bureau of Common Reporting Requirements (BCRR).

Section 2-15-114, MCA, requires all state agencies to implement safeguards to reduce, eliminate, or recover from threats to data and information. State policy provides a detailed description of the disaster recovery process required for systems that have been identified as critical by a state agency. Per state policy, the department is responsible for:

- Determining and documenting which information systems it considers critical.
- Ensuring the critical applications are stored off-site in a current and portable format.
- Designing each critical system so that it can be transported and operated using the resources available at the state's backup computer facility.
- Testing, with the assistance of ISD personnel, each critical information system at the backup computer facility.
- Participating in the operation of critical information systems in the event the central computer is unavailable due to a disaster.

A major disruption or breakdown in the state's mainframe computer could adversely affect the department's operations resulting in lost revenue and disruptions of vital state payments. Personnel at the department said they do not have sufficient EDP personnel to adequately develop a disaster recovery plan for the department's critical information systems. The department could reduce the amount of personnel time required to develop a disaster recovery plan by seeking the assistance of ISD or other state agencies who have established disaster recovery plans. If the department obtained a disaster recovery plan from another agency and modified the plan to fit the department's needs, the department could save a considerable amount of personnel time.

Recommendation B18-6a

We recommend the department develop a written and tested backup and recovery plan for its critical mainframe computer applications.

Response B18-6a

Concur. The department is reviewing the classification of it's main frame applications. If they are not critical the department will have them reclassified. If they are critical the department will contract with the Department of Administration for a backup and recovery plan.

B18-6b.
EDP Segregation of Duties

The computer programmer at the department is also the security officer for the department. Because the security officer has access to all mainframe system files, it is important that the security officer duties be segregated from other data processing functions such as programming. The segregation of duties between the programmer and security officer limits the ability of one person to perpetrate errors or irregularities and then conceal those errors or irregularities. Department personnel

indicated that the lack of segregation of duties was the result of not having an EDP staff large enough to allow for segregation. The security officer duties can be assigned to someone in the department outside the EDP section. This ensures segregation with the department's existing staff and additional costs will not be incurred.

Recommendation B18-6b

We recommend the department assign the duties of the EDP security officer and computer programmer to separate staff.

Response B18-6b
Concur. The duties of security officer have been assigned to a staff person that does not program on the mainframe.

B18-7. Accounting Issues

During the course of audit work, we identified accounting issues where the department did not comply with state accounting policy and generally accepted accounting principles (GAAP). State law requires the accounting records be maintained in accordance with generally accepted accounting principles. The issues we identified are discussed below:

1. In December 1987, the department hosted a conference entitled "Crisis in Prenatal Care in Montana." Prior to the conference, the department received a grant from a California university to help pay for the cost of the conference. During our audit work we discovered the department had not billed the university $4,455 for its portion of conference costs. The department's indirect cost account in the Special Revenue Fund absorbed the cost of the conference. When we asked department personnel about the conference they discovered the university had never been billed. The department has

since billed the university. Because of this error revenue and accounts receivable in the Special Revenue Fund are understated by $4,455 in fiscal year 1987-88.

2. While testing expenditure accruals, we found five of fifteen expenditures were recorded in fiscal year 1988-89 but should have been recorded in the previous fiscal year. The five exceptions noted related to expenditures recorded against continuing appropriations. State accounting policy and GAAP indicate that an expenditure should be charged against the fiscal year in which the services are provided. The department should have established expenditure accruals against its continuing appropriations since services had already been performed. Because the accruals were not established, expenditures and liabilities are understated by $65,000 in the General Fund and $91,461 in the Special Revenue Fund for fiscal year 1987-88.

3. The department incorrectly recorded several adjustment transactions. The errors occurred when the department's Support Services Bureau tried to reconcile revenue and expenditures in the federal Special Revenue Fund accounts. Department personnel improperly reduced prior year revenue when they should have increased prior year revenue. Personnel also improperly increased current year revenue when they should have decreased current year revenue. State accounting policy and GAAP require that the state's accounting records properly reflect the department's financial activity. The net result is that prior year revenue is overstated and current year revenue is understated by $348,599 for the Special Revenue Fund in fiscal year 1987-88. These errors could affect federal financial assistance in the following programs: Women, Infants, and Children (CFDA #10.557) or Child Nutrition (CFDA #10.558); PH Block grant (CFDA #13.991); MCH Block grant (CFDA #13.994); Water Quality (CFDA #66.454); Medicaid Certification Title 19 (CFDA #13.777); Medicare Certification Title 18 (CFDA #13.777); and Immunization (CFDA #13.268).

Department personnel indicated that the issues noted above were caused by a variety of circumstances including, but not limited to, insufficient number of accounting personnel.

Recommendation B18-7

We recommeod the department properly record transactions in accordance with state accounting policy.

Response B18-7

Concur. The department will make every effort to comply with state accounting policy when making accounting transactions. The examples stated have no effect on federal programs.

Federal Issues
Department of Labor and Industry

B19-1. Unemployment Insurance Assessments

In accordance with section 39-51-404(4), MCA, the Department of Labor and Industry collects an assessment on wages subject to unemployment insurance taxes (CFDA #17.225). According to this statute, the department is to deposit this money in the Special Revenue Fund for use as appropriated by the legislature. In the prior fiscal years 1983-84 through 1987-88 appropriation bills, the legislature allowed the department to use these funds only if federal funding for job services was below specified amounts. Through fiscal year 1987-88, the department had not used the money for job service offices. In September 1988, the department received a budget amendment to spend $350,000 of these funds to support job service offices. The statute further states any moneys not appropriated by the legislature be transferred to the U.S. Unemployment Trust Fund in Washington, D.C.

The department initially deposits these assessments in a bank account outside the state treasury and records it in the Expendable Trust Fund. Periodically, the department transfers both the assessments and interest earned on the assessments from the bank account to Washington, D.C. The department then uses these funds to pay unemployment benefits. The procedure used by the department understates Special Revenue Fund revenue by the amount of assessments collected and transfers out by the amount transferred to the trust fund. It also overstates revenue and understates transfers in the Expendable Trust Fund by the amount of moneys transferred from the Special Revenue Fund. The table below shows the amount of assessments collected since the implementation of this statute, the interest earned on the moneys before transfer to Washington, D.C., the amount transferred to Washington, D.C., and the balances which had not been transferred to Washington, D.C. at June 30, 1988.

Table 5

Unemployment Insurance Assessments

Fiscal Year	Assessments Collected	Interest Income	Transferred to Washington DC	Balance at June 30
1983-84	$ 1,425,199	$ 18,911	$1,420,858	$ 23,852
1984-85	1,981,841	35,898	1,985,852	55,139
1985-86	2,342,560	62,026	-0-	2,459,725
1986-87	2,337,729	169,418	4,000,000	966,872
1987-88	2,390,527	131,623	1,269,657	2,219,365
Totals	$10,478,856	$417,876	$8,676,367	

Source: Compiled by the Office of the Legislative Auditor

The department does not have authority to deposit these assessments in a bank account outside the state treasury. Also, the law related to the assessments does not specify where the department should deposit the interest income on these assessments while the cash is in the Special Revenue Fund. In accordance with section 17-6-202(2), MCA, the department should deposit the interest income in the General Fund. Since fiscal year 1983-84, the department has deposited this interest in the U.S. Unemployment Trust Fund. As a result, the U.S. Unemployment Trust Fund has received $417,876 of interest income belonging to the General Fund. Department personnel said federal law restricts payments from the U.S. Unemployment Trust Fund to benefit payments. However, the interest on assessments was deposited in the U.S. Unemployment Trust Fund in error. The department should recover these state moneys for the General Fund by either transferring the money back from the trust fund or reducing future transfers of this tax money to the trust fund.

Recommendation B19-1

We recommend the department:

A. Deposit the assessments in the Special Revenue Fund as required by state law.

B. Deposit $417,876 and future interest earned on the assessments in the General Fund.

Response B19-1

A. Concur. The department will begin this procedure when the current contract for banking services expires. However, we believe that the interest generated from these funds should follow the principle and be transferred to the Unemployment Insurance Trust Fund.

B. Do not concur. The administrative fund tax was created as a set-aside out of the unemployment insurance tax rate structure. Employers agreed to support the tax, so long as the collected monies not used to fund department activities reverted to the trust fund in the manner that they did under the original tax structure. To now transfer the interest from those funds would abrogate the trust of employers, and would have the effect over the long run of raising unemployment insurance taxes. The department will seek a change in the statute, if necessary, to ensure that the interest is credited to the UI Trust Fund.

B19-2. Electronic Data Processing Access

The Department of Labor and Industry has several computerized processing systems. We performed electronic access controls tests on the Employer Tax and Unemployment Benefit (CFDA #17.225) systems used by the Unemployment Insurance Division (UID) and the Employer Premium and Payroll Tax systems used by the Division of Workers' Compensation (DWC).

Access controls are physical or electronic safeguards designed to ensure computer system resources are properly used. Access controls consist of input controls instituted by the department for each application as well as access controls governed by ACF2, the state's mainframe computer security software. During our audit, we noted areas in which security over the department's programs and data can be improved. The problems identified increase the potential for unauthorized use of department data and programs. The following sections discuss concerns found during our audit.

ACF2 Rules

We reviewed the department's ACF2 access rules at both UID and DWC. In our examination, we identified the following concerns:

-- Some ACF2 rules, as written, allow all agency users full access to some critical applications. Such access allows users to change data and programs. However, many of the users do not need full access to perform their assigned work. Among applications affected are the unemployment insurance check writing system used by UID and the medical payments system used by DWC.

-- Two data files at the DWC are not protected by ACF2 because the file descriptions do not follow ACF2 naming conventions. The department relies on ACF2 to provide security over these mainframe applications. In addition, DWC personnel could not identify all data files, as critical or non-critical by examining the files listed by ACF2. As a result, we could not evaluate whether security rules for these files were adequate.

-- Users outside the department have access to critical application programs and data. An input/output controller at the Information Services Division of the Department of Administration has full access to data. A programmer at the Information Services Division has access to both programs and data. These individuals should not need full access to the programs or data.

The department should ensure access to programs and data files is limited to those individuals authorized to process or maintain particular systems. In addition, section 39-51-603, MCA, specifically requires that certain information be kept confidential and access to it be restricted. When security rules permit users access in excess of the level required for their job, the potential exists for unauthorized changes to data stored in the electronic data processing system. Weakness in both data file and program security increases the likelihood that an unauthorized transaction would not be detected.

Terminations

Active identification numbers, both within the ACF2 and each division's separate access system, provide an opportunity for exemployees to change, alter or destroy programs and data. When an individual terminates, the department should assign new identification numbers to the work stations. We tested a sample of 17 user identification numbers where the employee had either transferred to another division within the department or had terminated employment with the department. Of the 17 tested, we found five instances where the employees still had access to the department's data processing system after they were no longer employed by that division. Of these five, two worked at DWC and three worked at UID. Two of the terminated employees accessed the department's files after they were terminated using identification numbers. These two employees had privileges to access the unemployment benefit system subsequent to their termination date. The access by terminated employees occurred in one division which assigns the access codes to a work station rather than an individual. Division personnel stated, but could not document, that access gained by the terminated employees number was actually made by another division employee who performed job functions previously done by the terminated employees. The department's data processing security officer said a formal notification of employee termination from the personnel officer would enable access to the system to be ended in a timely manner.

Password Security

Passwords used for computer access are a security device to limit access to an individual. We identified three instances where department personnel shared passwords.

1. The system security officer allowed another department programmer to use his password.

2. A programmer shared a password with a systems analyst.

3. A researcher used the password assigned to a terminated employee.

The department, excluding the Division of Workers' Compensation, does not have policies or procedures disallowing the use of shared passwords. Department personnel said that employees sometimes shared passwords so that tasks could be performed if an individual were absent. To maintain access control and personnel accountability, the department should require employees to protect their individual passwords. Access rules should be written granting access, if necessary, to back-up personnel to ensure tasks are completed.

In one bureau, logon identifications and passwords are assigned to terminals rather than individuals. The use of shared passwords to access critical applications prevents the department from holding certain individuals accountable for the access achieved. To strengthen access controls where passwords are assigned to terminals, the department should change these passwords whenever there is a change of employees in the user group.

Security Officer Function

An ACF2 security officer can access all data and program files within an agency. Because the security officer has access to all system files, it is important that the security officer duties be segregated from other data processing functions. The department has a mainframe security officer and back-up security officer at both the Centralized Services Division and the Division of Workers' Compensation. We noted two instances where

security officers' duties and other data processing tasks were not adequately segregated. First, security officers at both divisions are also programmers. Secondly, the security officer at Centralized Services and the back-up security officer at Workers' Compensation review the violation reports.

The security officer has access to all files. A programmer with this unrestricted access has greater potential for altering files on the system. When the security officer or back-up security officer reviews violation reports, there is not a cross-check on the reasonableness of violations reported by the system and the corrective action taken by the security officer. Review of violation reports by a manager not involved with the data processing function provides strong segregation of duties. Department personnel believed that security officers were the only people able to understand the violation reports. Department management did not consider the potential problems caused by designating a programmer as security officer.

Although the security officer is responsible for implementing system security, monitoring the proper level of security should be the responsibility of the divisions' management. Management should direct the security officer to implement the proper levels of access and the items to be monitored on the violation reports to develop guidelines to ensure system security is maintained. Review of violation reports by a manager outside of the data processing function provides additional assurance over access security.

Recommendation B19-2

We recommend the department:

A. Restructure ACF2 rules to limit computer access to the level job duties require.

B. Implement procedures to ensure system access is cancelled for terminated employees.

C. Develop and implement procedures to protect password security.

D. Segregate incompatible job duties in the EDP function.

Response B19-2

A. Concur for Unemployment Insurance Division. The rules were changed for systems identified as critical for disaster recovery. This was implemented during 1989.

B. Concur for the Unemployment Insurance Division. UID has developed and implemented a written policy, "Identification Numbers and Passwords for Benefit, Tax and SYSM Computer Files," 2.17a P&EB. It requires users to notify the UID Internal Security Officer within three working days when an employee leaves or no longer requires access to the computer system. As a backup measure, the UID Internal Security Officer requests an employee terminations report from the Personnel and Training Bureau on a bi-monthly basis advising of any employee terminations. Any terminated employees showing on the password file are removed the same day the report is reviewed.

C. Partially concur. The Unemployment Insurance Division (UID) has two written and implemented

policies regarding password security: 1) "Identification Numbers and Passwords for Benefit, Tax and SYSM Computer Files" 2.17a P&EB; and 2) "Changing Passwords and Verification of Individuals Granted Access into the Unemployment Insurance Benefit and Tax Computer Files" 2.17d P&EB.

The "Identification Numbers and Passwords for Benefit, Tax and SYSM Computer Files" policy requires immediate notification to the UID Internal Security Officer when system access is no longer needed. Written notification must be submitted within three working days of the requested change. The request can be made by the user or his/her supervisor.

This policy also requires that an "ID & Password Request" form is completed on each individual requesting a password. The form includes a statement stating that passwords are not to be shared and gives information on confidentiality of the Benefit and Tax files. The new password user must sign a statement verifying they have read and understand the information regarding password use and confidentiality.

As a backup to this policy, the UID Internal Security Officer monitors bi-monthly personnel changes. Password and security level changes are adjusted accordingly.

The Internal Security officer has also requested the Personnel Office to add a statement to the department's exit interview form requesting supervisors to terminate an employee's password before he/she leaves. The "Changing Passwords and Verification of Individuals Granted access into the Unemployment Insurance Benefit and Tax Computer Files" policy requires that all user passwords are changed annually. Six months after a password changes, the policy requires the UID Internal Security Officer to conduct a formal verifica-

tion of each individual granted access to the Benefit and Tax files. A written report of the verification findings is given to UID management.

Even with written policy implemented, individuals sharing passwords with someone else is not fully controllable.

D. Concur for the Unemployment Insurance Division. The security officer function has been moved out of EDP.

B19-3. Internal Control

The existence of internal controls is an integral part in any organization's ability to safeguard assets, verify accuracy and reliability of accounting and management data, and promote efficiency. The following two report sections and the section on electronic data processing controls discussed above address internal control weaknesses we noted that compromise the safeguarding of department assets.

B19-3a. Unemployment Tax

The department receives wage reports and unemployment insurance (CFDA #17.225) payroll taxes from employers on a quarterly basis. These payments are based on wages paid by the employer during the quarter. We identified several situations where better segregation of duties among employees could improve internal controls over unemployment tax receipts:

-- The cashier prepares adjustments to data on the UI tax contributions system. As a result, the cashier has both control of tax payments and related recordkeeping duties. When one employee performs both of these functions, the risk exists of using the payment for personal gain and adjusting the records to cover up that fact. Although department procedures require a review of the cashier's adjustments by a supervisor, we found no documentation that the supervisor actually reviewed the adjustments.

-- Some employers submit quarterly wage reports on computer tapes that have non-standard formats. Before the programmers run these employer wage record tapes, the department's programmers must alter the tape formats so the information can be run on the department's system. Since programmers are usually aware of the details in an application program, the department should not have the programmers operating the system. This would prevent programmers from being able to circumvent certain software controls.

-- A secretary and a clerk have "write" access to screens on the unemployment insurance tax system that are used to enter employers quarterly reports, record payments received from employers, make adjustments, and change tax rates and wages. Both employees also receive mail containing quarterly reports and handle payment checks prior to restrictive endorsement. Again, these employees have both control of assets and recordkeeping duties.

The department could adequately segregate duties with existing personnel.

Recommendation B19-3a

We recommend the department ensure adequate segregation of duties among employees administering unemployment taxes.

Response B19-3a

Concur. The cashier prepares adjustment documents correcting input errors only on original quarterly wage reports that have been entered. The cashier does not have access to and does not enter any data into the Unemployment Insurance Tax Accounting System. The adjustment documents made by the cashier are initialed by the cashier's supervisor as approved. Adjustment documents prepared by the cashier are accompanied by a copy

of the original quarterly report to justify the correction. The adjustment document is approved and initialed by the Employer Accounts Supervisor.

The programming performed to enable magnetic tapes to be processed cannot change the wage amounts on the tapes. The wage information is verified by Contributions Bureau personnel after it is updated on the Benefit System. Beginning with the third quarter of 1988, all magnetic tapes are processed through Production Control. A program is now in place to accomplish this.

The secretarial position that previously opened mail and input during the end of the quarter no longer performs input duties. The clerical position that also prepared adjustment documents is only authorized to input original quarterly reports at the end of the quarter. During this time, this position performs only input duties and is not allowed to prepare input documents. This is monitored by having the preparer's supervisor review and initial the input documents. Duties have been segregated so that any position which opens mail or prepares input documents does not perform input duties during the same period.

B19-3b.
Check Custody and Recordkeeping

Unemployment (CFDA #17.225) and workers' compensation benefit checks are sometimes returned to the department as undeliverable. The checks are kept in locked drawers until a proper disposition is determined. A log of the checks in the drawer is also maintained. We noted that for each type of benefit, the same person is responsible for custody and record-keeping for the checks. A similar condition was identified in our prior audit report. When these two duties are not segregated, there is increased risk of misappropriation of checks and altering of the records.

In an unannounced audit of the undelivered unemployment benefits check drawer, we found 40 checks in the drawer. We observed two checks in the file that had not been recorded on the corresponding check log. We also noted three checks

recorded on the check log were not in the drawer and no disposition of the checks had been documented. We saw two checks to one beneficiary in the file. Subsequent to our field work, the department developed a written policy to remedy this situation. However the procedures do not specify the frequency of supervisor review of the undelivered check file. Also, department supervisory personnel should periodically perform a comparison of the checks in the drawer to the log to ensure the two agree.

At DWC, one individual has responsibility for recording undeliverable checks and refunds and has custody of these checks. Although checks are logged daily, the checks are not always logged as they are received. The individual sometimes holds the list of checks and the checks for several days until the disposition of the check is determined and recorded on the claimant's file. With this procedure, the potential exists for checks to be lost or stolen. Internal control over these checks would be strengthened by separate personnel having physical custody and recordkeeping for the checks.

Recommendation B19-3b

We recommend the department strengthen controls over undelivered benefit and refund checks.

Response B19-3b

Concur for the Unemployment Insurance Division. A written procedure/policy instituted at the time of the audit provided for periodic supervisory comparison of the actual returned checks and the returned check log and for a separation of duties between two individuals, one who retains physical custody of the checks and the other who maintains the log of returned checks.

The policy has since been reviewed and further instituted based upon recommendations of the Benefits Accounting Task Force.

B19-4.
Accounting Records

Financial information of the department is used by department officials and legislators to manage and establish funding levels for the department. The department uses the Statewide Budgeting and Accounting System (SBAS) to record its financial activity. Section 17-1-102(4), MCA, indicates "all state agencies, . . . shall input all necessary transactions to the accounting system . . . before the accounts are closed at the end of the fiscal year in order to present the receipt, use, and disposition of all money and property for which the agency is accountable for in accordance with generally accepted accounting principles (GAAP)."

We noted the following instances where the amounts the department recorded on SBAS did not comply with state law:

1. The department did not record $116,153 in equipment purchased and recorded $82,102 of buildings as equipment on the state's system during fiscal year 1986-87. State accounting policy requires the department to record fixed assets on the accounting system concurrently with the recording of the expenditures and to properly classify its assets.

2. The department recorded a prepaid expense for an expenditure transaction until it established a responsibility center. When department personnel cleared the prepaid expense account to record the expenditures, they improperly charged a prior year expenditure. As a result, fiscal year 1987-88 year expenditures were understated and fiscal year 1986-87 expenditures overstated by $11,274 in the Special Revenue Fund.

3. The department completed payments on two bond issues held by the Public Employees Retirement System in fiscal year 1987-88. However, it had $126,310 in bonds payable recorded in its accounting records at June 30, 1988. The department should remove the debt.

4. The department recorded activity relating to Centralized Services Division in the Internal Service Fund in fiscal year 1987-88. According to state policy, the

department should record activity such as fixed assets, depreciation expense, and compensated absence liability in the Internal Service Fund.

5. The department records certain federal unemployment (CFDA #17.225) benefit and allowance (FUBA) payments as grants expenditures rather than benefits and claims as other unemployment payments are coded. The department recorded FUBA expenditures of $132,863 and $66,401 for fiscal years 1986-87 and 1987-88, respectively. For consistency, the department should record these expenditures as benefits and claims.

6. The department classified interest earnings on the state's unemployment insurance (CFDA #17.225) balance in the U.S. Unemployment Trust Fund as federal assistance rather than as interest earnings. In addition, the department classified reimbursements of benefits paid to federal employees as employer contributions rather than as federal assistance. As a result the department understated interest earnings revenue by $2,267,646 and $3,362,571 and overstated employer contributions revenue by $2,670,000 and $2,705,000 for fiscal years 1986-87 and 1987-88, respectively. Federal assistance revenue in the Expendable Trust Fund was understated by $402,354 in fiscal year 1986-87 and overstated by $657,571 in fiscal year 1987-88.

7. We noted the department had four accounts with federal funds that had fund balances. The majority of federal funds affected involve the Job Training and Partnership Act (CFDA #17.250), Unemployment Insurance Base (CFDA #17.225) and Wagner-Peyser (CFDA #17.207). State accounting policy requires agencies to accrue as revenue money owed by the federal government and to defer recording revenue for federal cash received in excess of expenditures. As a result a net overstatement of $22,966 and a net understatement of $180,173 in federal assistance revenue in the Special Revenue Fund for fiscal years 1986-87 and 1987-88 respectively, occurred.

8. The department did not record the liability of the State Compensation Insurance Fund (SCIF) on SBAS in the Expendable Trust Fund. The liability consists of the present value of payments related to claims that have

already been incurred. Since payment is probable and the amount of payments is estimable, the liability should be recorded on the state's accounting records at its most current estimated value. The consulting actuary employed by SCIF estimated the liability at $206.4 million as of June 30, 1988. The fund balance of the department for the Expendable Trust Fund should be reduced by the amount of the unrecorded SCIF liability.

Without all financial activity recorded on the state's accounting records, the quality, consistency, and comparability of the resulting financial information is affected. Department personnel cited human error as the reason for year-end balance and accrual misstatements.

Recommendation B19-4

We recommend the department establish procedures to ensure the financial activity recorded in SBAS is in accordance with generally accepted accounting principles.

Response B19-4

The department makes and has made an extensive effort to ensure accurate and complete recording of financial activities. Further automation of internal accounting functions will increase efficiency and accuracy. As with any system, errors can and will be made. The department has taken specific steps to correct the errors referenced in the audit report.

1. The department now reconciles all entries between the (11000) General Fixed Assets Group and PAMS. We now make the entries necessary to ensure that both systems are correct and reflect the most current information by fiscal year end.

2. The department agrees with the Auditor's findings and instituted procedures at fiscal year end to minimize the possibility that the error will occur again.

3. The department corrected its accounting records in December, 1988, and removed the payable from its records.

4. The department concurs and has taken corrective action to record the missing activities by fiscal year end.

5. The department has changed its SBAS ICC and is now recording the expenditures as benefits and claims.

6. The department concurs, and has implemented the necessary changes.

7. The department concurs. Within the past two years, the department has made a concentrated effort to automate procedures to ensure the recording of proper fund balances. As we continue to automate and improve these procedures, errors will be reduced. Prior to this automation, an accurate matching would not have been possible.

B19-5.
Allowance for Doubtful Accounts

The department established an allowance for doubtful accounts for unemployment insurance (CFDA #17.225) receivables at fiscal year-end 1986-87 as recommended in our previous audit report. When recording the allowance, department personnel incorrectly reduced current year revenue by the total estimated bad debt at June 30, 1987. According to state accounting policy, the department should record an expenditure when establishing the allowance account. As a result of the method used by the department to establish the allowance, fiscal year 1986-87 revenues, expenditures and prior year expenditures were understated by $2,842,752, $287,508 and $594,637 respectively, in the Expendable Trust Fund. In addition, fiscal year 1986-87 expenditures were understated by $355,237 in the Special Revenue Fund because the allowance related to penalty and interest receivable was recorded in the wrong fund.

When the department wrote off uncollectible receivables in fiscal year 1987-88, it incorrectly reduced revenue. The procedure understated revenue by $263,963 in the Expendable Trust Fund. According to state accounting policy, uncollectible receivables should be written off against the established allowance account. The department also transferred $282,433 of unemployment insurance receivables to the Department of Revenue as uncollectible. It did not remove these receivables from its accounting records.

The department recorded uninsured employers accounts receivable of $736,331 and notes receivable of $104,037 in the Expendable Trust Fund at June 30, 1988. Department management estimated that only 51 percent of the accounts receivable and 80 percent of the notes receivable were collectible. Since the department did not record an allowance for doubtful accounts, net accounts receivable and notes receivable were overstated by $360,802 and $20,807, respectively, on the state's accounting records.

Recommendation B19-5

We recommend the department record allowance for doubtful accounts according to state policy.

Response B19-5

Concur. The department has implemented the necessary changes.

B19-6. Abandoned Property

The department established an account in the Agency Fund for moneys held for participants in the Comprehensive Employment and Training Act (CETA) program (CFDA #17.232). Even though the CETA program was discontinued in 1983, $2,843 remains in the Agency Fund, unclaimed by the participants. According to section 70-9-207, MCA, all intangible personal

property held for the owner by public authority of the state that has remained unclaimed for more than five years is presumed to be abandoned. Section 70-9-301, MCA, requires the department to turn over abandoned property to the Department of Revenue. State law specifies procedures available to the Department of Revenue to recover abandoned property for the state. By turning the abandoned funds over to the Department of Revenue, the department can initiate recovery of the abandoned CETA moneys.

Recommendation B19-6

We recommend the department transfer abandoned property to the Department of Revenue in accordance with state law.

Response B19-6

Concur. The department will transfer the $2,843 in unclaimed CETA participant wages to the Department of Revenue in accordance with state law.

B19-7. JTPA Program Expenditures

The department prepares periodic expenditure reports for its federal grants. We reviewed the fiscal years 1986-87 and 1987-88 JTPA Title IIA (CFDA #17.250) expenditure reports. We noted unreconciled differences of $2,648 and $2,852 between the federal report and the state's accounting records for fiscal years 1986-87 and 1987-88, respectively. Federal regulations require recipients of federal grant funds maintain an accounting system that identifies the source and use of federal funds received by the recipient. In addition federal reports should be supported by the accounting records. The department should establish procedures to ensure the federal reports are supported by the state's accounting records.

Recommendation B19-7

We recommend the department adopt procedures to ensure federal financial reports are supported by the state's accounting records.

Response B19-7

Concur. The department has converted accounting subsystems to SBAS over the last couple of years and we are still fine tuning that system. We currently input detail accounting transactions into SBAS which will ensure the federal reports match to SBAS.

B19-8. Job Training Conference

The department paid for a conference for the Job Training Coordinating Council in June 1989 with Job Training Partnership Act (CFDA 17.250) funds. As part of the conference costs, the department paid the hotel directly for certain meal and meeting room rental costs. We found several instances where the department exceeded the per diem meal rates set by state law.

- Department personnel reimbursed some participants for meals claimed on travel expense vouchers and also paid the hotel directly for the meals.

- One participant claimed and received reimbursement for lunch expense even though he was not in travel status as defined by state law.

- The department payment to the hotel exceeded the allowable per diem amounts for meals because department personnel did not consider meeting room rental and gratuity charges as part of meal cost.

As a result, the department spent $1,144 more for meals at the conference than allowed by state law. We question the allowability of these costs as charges to the JTPA grant. Department

fiscal managers said improved planning and coordination of information related to future events of this type could prevent overpayments.

Recommendation B19-8

We recommend the department implement procedures to ensure conference costs comply with state law.

Response B19-8
We concur. The department has established administrative procedures to ensure that its JTPA conference costs are charged properly and comply with state law.

B19-9. Job Training Eligibility

The department's Job Service Division provides training and support services with Job Training Partnership Act (JTPA) funds (CFDA #17.250). We tested a sample of 37 JTPA clients served by Job Service for eligibility under program regulations. In one case, we found that department personnel did not include the military pay of the client's spouse when determining her eligibility. When the department determined that the individual did not satisfy the income limits for JTPA eligibility, personnel enrolled her under a category for clients with significant barriers to employment. JTPA providers may enroll up to 10 percent of the JTPA clients who have employment barriers (such as an education deficiency) regardless of the client's financial resources. However, the case file did not document a significant barrier to employment that qualified the client for enrollment under this category.

Since the client was not eligible for JTPA services, we question the allowability of $1,575 in JTPA costs. According to Job

Service officials, the department changed the eligibility determination because the client's service contract was almost complete when the initial eligibility error was discovered.

Recommendation B19-9

We recommend the department use proper criteria in determining eligibility for JTPA services.

Response B19-9

The Job Service Division agrees with the recommendation made by the Legislative Auditors. Our staff does make every effort to utilize proper criteria in determining eligibility for JTPA services. Our self-monitoring system and management review are in place to ensure that proper criteria is utilized.

Last year we did change our verification worksheet to include the 10% Window documentation of barriers checklist. This was a procedural/system change intended to ensure that barriers are documented before enrollment.

The information contained in the audit report was very non-specific, making it difficult for us to respond with any detail. Without knowing the specific case, we could not determine (1) whether the spouse was a veteran or a military person; (2) whether the military income was of a source that should or should not be counted; and (3) whether the person had or did not have barriers that may not have been documented properly.

The sample size was very small -- 37 out of hundreds or thousands, depending on the elements being measured -- which doesn't provide enough data to determine whether this may be a one-time occurrence or a system problem.

The Job Service Division enrolls a very small percentage of individuals under the 10% Window eligibility. For this current

year to date, 1.2% of our total enrollees were enrolled under the 10% Window.

With this small number of 10% Window enrollees, the case mentioned in the auditors report sounded very similar to an incident in Great Falls. If the case reported by the auditors is the same case we remember, we can provide a full explanation. The person was eligible at the time of enrollment based on the criteria in the JTPA Manual.

We're sure the auditors must be aware of the changes in the JTPA Manual during 1988, which redefined the income of members of military service on active duty from an exclusion to an inclusion. This manual change was a result of the case mentioned above.